

## Conclusions of Program for Fair Investor Access, Responding to Activism

**Investing in enterprise value**  
**Current conditions supporting professional activism**  
**Confusion about responsibilities**

The Forum's program for "Fair Investor Access" was initiated to provide marketplace tests of "best practices" to be defined by a coordinated Conference Board Task Force on Corporate/Investor Engagement,<sup>1</sup> and these efforts have naturally become focused on issues raised by the recent growth of professional "activist" funds.

The concluding observations of Forum participants are summarized below. It should be noted that we devoted considerable attention to such issues as activist encouragement of short term trading price benefits at the expense of long term enterprise value, but that this report is focused on the Forum's purpose to identify and support the very practical opportunities that activism creates for

- *long term investors to realize the intrinsic value of companies,*
- *corporate managers to demonstrate responsible leadership, and*
- *policy makers to clarify fiduciary responsibilities concerning corporate capital.*

In concluding this program, I want to thank The Conference Board staff and all of the Forum participants who have asked questions and offered comments – especially the Forum's [Program Panel](#) members who volunteered a few months of guidance when we started in 2012.

### Investing in enterprise value

In the context of our interest in long term enterprise value, the current wave of activist proposals can be viewed essentially as a disruptive process that transfers business assets from weak to strong managers. Proposals for stock buybacks, for example, may raise questions about using corporate capital to placate activists in a new variation of greenmail,<sup>2</sup> but as a practical matter any board that accommodates these demands has effectively admitted that its responsibility for assets should be transferred – and has served both short term and long term investors by doing so.

Like any other disruptive process, activism will create opportunities for investors. These are some of the opportunities we have observed, and we should be alert for more:

- ▶ ***Realizing long term intrinsic value in buyouts*** – When activist pressure to promote short term stock price stimulates a buyout, public shareholders can now use independently

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<sup>1</sup> For the program's plan, see its [Forum Summary](#); for the Task Force recommendations of communication practices and an authoritative analysis of how those practices evolved, see the [March 11, 2014 Forum Report: The Conference Board's Task Force Definition of Responsibilities for Investor Access](#). For broader considerations of the Task Force recommendations by a member of its Advisory Board, see [December 12, 2014, Holly J. Gregory of Sidley Austin LLP posting in The Harvard Law School Forum on Corporate Governance and Financial Regulation: "Corporate Governance Issues for 2015"](#).

<sup>2</sup> For observations in a case example of a company's response to pressures for stock buybacks, see the [November 14, 2014 Forum Report: Initial Comments on Walgreen Buyback Issues](#).

administered appraisal rights to realize the same intrinsic value of a company that private equity investors are getting at a “forced sale” bargain price.<sup>3</sup>

- ▶ **Improving management** – Contests for control will present opportunities for investors to support enlightened board candidates – either incumbent or dissident – who advocate alignment of executive compensation with enterprise performance instead of stock price.<sup>4</sup>
- ▶ **Demonstrating leadership** – Investors will be able to identify corporate managers who address activist challenges with responsible leadership<sup>5</sup> instead of hiding behind professional defense playbooks.<sup>6</sup>

Long term investors can exploit these and other opportunities to generate competitively differentiated returns. Those of you concerned with policy – including economists as well as fund managers – can also make use of these opportunities to demonstrate the financial benefits of sound investment and capital allocation principles.

### Current conditions supporting professional activism

To respond effectively to the current form of “agency activism,”<sup>7</sup> it is important to consider how it may be shaped by market conditions that differ from those of past raiding cycles. We can of course expect a similar pattern of expansion and gradual decline as suitable targets are eliminated, but these new conditions may significantly expand both the criteria for target suitability and the number of activists, and thus require more careful investor consideration of an activist’s issues.

1. Short term values: Whatever philosophy they offer, professional activists are fund managers who make money from quarterly measurements of stock prices, directly as a basis for fees and indirectly as a performance measurement in marketing a fund. These fee and performance measurements are not changed by the period of time a fund manager expects to hold a stock in the portfolio. We must recognize that competition for “success” as an activist will inevitably be based on generating short term increases in stock prices.
2. Selection of targets: Considering their need for short term performance measurement and advertising, activists must select targets that present opportunities for the activist to be

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<sup>3</sup> See [June 23, 2013 New York Times Fair Game: "For Dell Investors, a Safety Valve"](#); see also [December 4, 2014 Bloomberg: "Michael Dell Predicts More Buyouts as CEOs Seek Sale Advice"](#) and [December 15, 2014 Bloomberg: "Activists Jana, Elliott Each Gain 40% on PetSmart and Riverbed"](#).

<sup>4</sup> See the two related reports of Organizational Capital Partners commissioned and published by the Investor Responsibility Research Center Institute (IRRCi): [November 14, 2014, "The Alignment Gap Between Creating Value, Performance Measurement, and Long-Term Incentive Design"](#) and [December 22, 2014, "The Alignment Gap Between Say on Pay Voting and Creating Value"](#).

<sup>5</sup> See the [August 11, 2014 Forum Report: Corporate Responsibilities for Issue Definition and Information Access](#).

<sup>6</sup> See [September 14, 2014 Financial Times: "US companies devise tactics to limit activists' advances"](#) and [October 10, 2014 Financial Times: "Starboard sweeps away entire Darden board"](#).

<sup>7</sup> See [January 2013, Ronald J. Gilson and Jeffrey N. Gordon of Columbia Law School: "The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights"](#); for earlier views, see the [May 2012 private discussion draft](#) presented to Forum participants for comment.

credited for “unlocking value.” Screening has generally been based on observations of disappointing stock price trends or unpopular governance practices that provide a foundation for attracting broad shareholder support of an activist’s corrective proposal. It has become common practice to test candidates quietly for defense playbooks that promise either appeasement or noisy escalation, and with the great increase in activist funds this testing is often done by the smaller entrants who can gain recognition by attracting more established allies. There are also indications that some activists are following the practices of 1980s raiders by targeting companies that engage professionals whose defense playbooks can be expected to discourage investor support of their client.

3. Influence of corporate defense advisors: The process of activist “engagement” presents significant opportunities for professional advisors specializing in corporate management defense, not only for fees relating directly to the response process but also for transactions and corporate actions that the advisors will be in a position to recommend.<sup>8</sup> This market opportunity has been addressed very successfully by a few legal, financial, and public relations advisors that present similar views of the need for boards to be guided by a specialized “team” of experts experienced in the application of a recognized playbook,<sup>9</sup> even though the playbook consistently rewards the attacking activists with escalating rounds of credibility enhancement and ultimate victory.<sup>10</sup>

### **Confusion about responsibilities** [See [endnote](#) for subsequently published legal views.]

An important observation for policy-makers is that both activist proposals and management responses have often appeared to be inconsistent with previously accepted principles of corporate responsibility. Confusion about these fundamental responsibilities of both corporate and fund fiduciaries should be resolved to provide a sound foundation for considering activist proposals, as well as for any other corporate capital allocation decisions:

- **Corporate purpose** – In what is now a familiar issue to Forum participants, distinctions must be made between short term interests in the market prices of securities and long term interests in the enterprise value of a corporation. Both short term and long term investors deserve equal respect, of course, but the integrity of corporate capital upon which both rely requires uncompromising management of the corporate interest. This principle has been challenged by recent practices that use corporate capital or concessions of other corporate resources to accommodate short term interests of activists.
- **Fiduciary judgment** – Questions have been raised about both investors and corporate managers relying upon advisors to make decisions that should be based on the judgment of fiduciaries. Concerns about fund managers using proxy advisors or standardized

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<sup>8</sup> See [December 17, 2014 Wall Street Journal: "Banks Find Niche Helping Firms Defend Against Activists | Assignments Can Help Land Fees for Deal Advice"](#).

<sup>9</sup> See [November 6, 2014, Martin Lipton of Wachtell Lipton Rosen & Katz posting in The Harvard Law School Forum on Corporate Governance and Financial Regulation: "Dealing With Activist Hedge Funds"](#).

<sup>10</sup> See [October 14, 2014 New York Times DealBook: "As Activist Shareholders Gain Strength, Boards Surrender to Demands"](#); for an activist advisor’s view of professional defense playbooks, see [October 5, 2014 Kenneth Moelis video interview and summary by Financial Times: "Take the fight to activists, says Moelis"](#).

policies are of course not new. But now many corporate directors also appear to be adopting professionally developed defense playbooks as responses to activists rather than making their own judgments about corporate interests.

Your continuing questions and comments, as well as your suggestions of Forum support, will of course be welcomed.

GL – January 5, 2015

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\* Members of the Forum's [2010 Program Panel](#) for Electronic Participation in Shareholder Meetings ("E-Meetings")

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Note: For subsequently published legal views supporting the observations summarized [above](#) regarding responsibilities for long term enterprise value, see

- [Winter 2014/2015, J. Travis Laster of the Court of Chancery of the State of Delaware and John Mark Zeberkiewicz of Richards, Layton & Finger, published in \*The Business Lawyer\*: "The Rights and Duties of Blockholder Directors"](#) [Legal foundations of requiring that all directors exercise independent fiduciary judgment to "maximize the value of the corporation over the long term for the benefit of the [stockholder] providers of longterm (i.e., presumptively permanent) capital"]
- [March 20, 2015, Leo E. Strine Jr., of the Supreme Court of Delaware, published by the University of Pennsylvania Institute for Law and Economics: "The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law"](#) [Legal definition of board duties to serve long term stockholder interests]