NACD NJ PROGRAM

AN ACTIVIST DIRECTOR: GOOD OR BAD FOR YOUR BOARD?

On April 21, 2016, the Chapter membership participated in an interactive debate between an activist investor, Kenneth Traub of Raging Capital Management, and a dean of the activist defense bar, Keith Gottfried, partner in the global law firm Morgan, Lewis & Bockius, LLP. Structured in point/ counterpoint fashion, the debate featured a free flowing exchange of ideas between the panel and a very engaged audience. The proceedings were moderated in evenhanded fashion by Emilio Ragosa, also a partner at the Morgan Lewis firm.

The panelists agreed that the number of public company proxy fights triggered by activist investors is now averaging about thirty per year, a rather modest number. But in some cases, these have been headline grabbing due to the "household names" involved, hence the great current national interest in the subject. Once an activist investor has made a decision to affect company management, it must be disclosed on a Schedule 13D filed with the SEC.

Are all activists the same? Mr. Traub began by noting that, despite press reports to the contrary, not all activist investors have the same goals and really should not have the same "activist" label. Some are undoubtedly seeking to make the quick buck or to make change for change's sake. But others are active because they believe the existing Board has not been successful in unlocking long term shareholder value. This category of activist is motivated by an analysis that the intrinsic value of the company is significantly greater than its stock market value. In this case, the investor designee is free of conflict because he is acting in the legitimate interest of all shareholders, not just the activist. Mr. Traub pointed out that it is often the case that the incumbent Board members may be correctly perceived as having more conflicts than the activist designee, for example, the desire to continue to earn compensation as Board members as the fortunes of the company decline or an inability or, more often, unwillingness to admit error. In those cases, it is likely that the Board, without activist pressure, would be all too willing to "double down on a bad bet."

How should a company deal with an activist investor? Mr. Gottfried advised that the presence of an activist shareholder should not be ignored by the Board. Essentially the Board is faced with a potentially serious political problem that, like all such problems, should be handled by dialogue. Usually if an activist investor asks to meet with senior company representatives, it means that there is already a problem at the company that is not being recognized. The orchestration of such a meeting is important. For example, SEC disclosure deadlines need to be kept in mind and an advance nondisclosure agreement insisted upon. If the Board is involved in the meeting, the whole Board ought to be present, not just the Chair or a committee, and Board feedback needs to be in accordance with a pre-arranged script and not done on the fly. The best long term approach would involve the Board thinking like activist investors on their own, a process that would start with the composition of the Board. This could avoid the problem from ever surfacing in the first place. Mr. Traub agreed that simple dialogue can be very constructive in defusing confrontation and observed that companies with good communications are much less likely to have activists interested in them.

How do activists choose their Board representatives? Mr. Traub admitted that all too commonly the skill set of the chosen person is wrong for the situation. The person chosen by the activist investor should be someone who can make the transition from being a critic to being a consensus builder as part of the new Board team. Mr. Gottfried has found that activist investors have little interest in negotiating about the credentials of a putative designee, observing that the quality of activist designees has deteriorated of late. Possible reasons for this, he observed, might be activist laziness in simply recycling the same candidates through multiple companies or the real difficulty in attracting qualified independent people because of the perceived "taint" that can come in being labeled an activist designee. Mr. Traub countered that, if this is true, the activist defense bar is mainly to blame, citing personal attacks against designees via press release and objections to extra pay for designees, as expressed in recent efforts to ban differential pay for directors via ByLaw amendment. Mr. Traub expressed his belief that incentive payments by the investor to the designee (so called "golden leashes") are always disclosed and should not always be perceived as an objectionable conflict of interest since the device is merely a recruiting tool to attract the right type of designee to accept what can be a difficult personal situation. It also might be true that the company is having difficulties for the very reason that it is not willing to pay its board enough to attract the right people.

Mr. Gottfried concluded by observing that a Board that does a professionally managed pre-emptive Board assessment is going a long way to head off problems with activists down the road.