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By Nicholas Peck

Defending Against Shareholder Activist Attacks: Identifying Their Vulnerabilities (And Yours, Too)

Activist investors typically target a company due to perceived performance issues, questioning the merits of a company's business strategy and lamenting weak shareholder returns. Such criticism is certainly fair game for any shareholder, and all companies should be prepared to defend their vision. However, these activist attacks can all too quickly develop into proxy contests, where the qualifications of both the activist's proposed slate of board candidates and the company's current directors often play a central role in the outcome of the fight.

In these cases, the targeted company will look for certain disqualifying themes when criticizing an activist's proposed slate—*e.g.*, the candidate does not have relevant experience in their type of business, or the candidate is a professional "hired gun" with a track record of short-term turnarounds at the expense of long-term stability.

Criticism of the proposed slate can also be more personal in nature. Putting forth a candidate with an undisclosed criminal record, personal bankruptcies, fake college degrees, or a pattern of arrests for driving under the influence could have disastrous consequences for an activist and his candidate—not only does it damage the candidate's credibility, it also sends a message that the activist has not even bothered to adequately vet his or her own slate.

And, for a variety of reasons, there are more potential pitfalls than ever for candidates. In the age of the #MeToo movement, sexist practices and inappropriate behavior that may have been swept under the rug in the past are no longer likely to be ignored. This means that even if a proposed candidate was not personally implicated in the practices, if they held a position at a company where they were responsible for corporate governance, they are vulnerable to charges that these practices occurred on their watch.

Another relatively new phenomenon that can create vulnerability for a candidate concerns the rise of social media. Aside from possibly undercutting a proposed candidate's current position (*e.g.*, the candidate posted a comment supporting the current management six months prior to the start of the proxy contest), "personal" postings can prove to be highly embarrassing for both the candidate and, by extension, the activist shareholder who advocated for them. For example, repeating conspiracy theories or "liking" extremist hate groups—while not directly relevant to issues impacting the target company—

will almost certainly destroy the candidate's chances for appointment and would likely undermine the chances of the entire slate.

Of course, a target company's board is vulnerable to the same attacks and, rest assured, aggressive activist shareholders will be looking for the same information. With this in mind, companies need to be more proactive, rather than reactive, in identifying potential problems with its management. To that end, companies should conduct self-due diligence on its existing directors and C-suite executives. It is not unusual to find companies with long-term directors who never underwent appropriate vetting before their appointment. Similarly, any new directors should undergo the same level of due diligence that you would apply when looking at an activist's proposed slate in a proxy contest. In the case of existing directors or officers, understanding their vulnerabilities will allow the company to take preemptive action as needed. Having to let go of a senior executive because of a falsified resume will lead to negative media coverage but will ultimately be much better for the company than having the information exposed by an activist shareholder in the middle of a proxy contest.

Whether you are trying to convince outside shareholders of the merits of your vision versus that of an activist shareholder or entering into settlement negotiations with an activist, understanding the vulnerabilities of an activist's slate—and objectively recognizing the vulnerabilities of a company's senior management—will help you define the best strategy for moving forward.

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