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# Activist investors push to accelerate changes highlighted by pandemic conditions — 2022 Outlook

28 January 2022 | 15:48 EST

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- Private engagement points to activity close to pre-pandemic levels
- Activists' deal focus expected to continue
- Universal proxy could shift future behind-the-scenes discussions

Corporates and shareholder activists alike are preparing for a much more active proxy season going into 2022 after a year marked by as many public settlements as private ones, said Dan Burch, CEO of **MacKenzie Partners**.

In North America, activists publicly launched 103 campaigns in 2021 – still significantly below pre-pandemic levels, according to *Activistmonitor* data.

Over the past year, shareholder activists were selective in their public campaigns amid rich market valuations and continued pandemic uncertainty, said Daniel Kerstein, **Barclays'** global head of activism defense.

Still, statistics tell only part of the story, as there has been a growing desire among corporates to proactively address activist demands or privately engage to reach a settlement agreement, said Derek Zaba, co-chair of **Sidley Austin's** shareholder activism practice.

Including private engagement, activity levels have returned to pre-pandemic or higher levels, said Kevin Daniels, managing director in **BofA Securities'** M&A/activism & raid defense practice.

## Investors focus on simplification

Breakups have been in particular focus in the back half of 2021, and high profile demands from activists are likely pushing many corporates and investors to revisit the issue, said David Rosewater, **Morgan Stanley's** global head of shareholder activism and corporate defense.

In November, department store **Macy's** [NYSE:M] said it was studying the value of separating its e-commerce unit following pressure from **JANA Partners**. More recently, activists **Engine Capital** and **Macellum Capital Management** have each asked **Kohl's** [NYSE:KSS] to consider the option as part of their campaigns.

The pandemic has been a catalyst for new revenue opportunities in various retail sectors, and as some companies are successful at monetizing these opportunities, we can expect that shareholders may question why their peers are not moving as quickly or in the same direction, said Keith Gottfried, CEO at **Gottfried Shareholder Advisory**.

Meanwhile, Dan Loeb in October pushed for **Royal Dutch Shell** [LON: RDSA] to explore a breakup of legacy energy assets and renewables.

As the interest of investors in clean energy and green investments grows, companies with mixed portfolios may be pushed to consider carving out their clean energy assets, Gottfried said.

The question that Loeb asks is relevant for companies across sectors that have been investing in more sustainable operations or business lines as they consider how to best fund growth, Barclays' Kerstein said.

Still, institutional investors have not formed a consensus on how to manage such disparate businesses, said James Langston, partner at **Cleary Gottlieb Steen & Hamilton**, pointing to **State Street's** recent critique of so-called "brown-spinning" in a letter outlining their proxy voting agenda for the year.

### **Rich valuations set tone for bumpitrag**

Meanwhile, amid an extremely active M&A market over the past year, activist campaigns pushing for sales or higher deal prices have become a more common tactic than operationally focused campaigns that rose in prominence the years preceding the pandemic, said MacKenzie's Burch.

In November, software firm **Vonage** [NASDAQ:VG] struck a deal to be acquired by **Ericsson** [NASDAQ:ERIC] following JANA's reported push for Vonage to explore options including a sale. More recently, JANA has been mounting a pressure campaign at aerospace and defense technology company **Mercury Systems** [NASDAQ:MRCY], where **Starboard Value** has also taken an interest.

Generally, many activist campaigns that start with publicly stated concerns on governance or performance are ultimately about positioning a company for an eventual sale process, said BofA's Daniels.

As valuations remained rich in certain pockets of the market last year, shareholder opposition to announced deals has been in particular focus, Burch noted.

In September, **Zoom Video Communications** [NASDAQ:ZM] called off its all-stock deal to buy **Five9** [NASDAQ:FIVN] after sellside shareholders opposed the deal. Software company **Zendesk's** [NYSE:ZEN] pending all-stock deal to acquire SurveyMonkey owner **Momentive Global** [NASDAQ:MNTV] has faced opposition

from some investors on both sides since it was announced in October.

Deals that represent a sudden strategic pivot, or all-stock deals, have tended to be more vulnerable to buy-side opposition, said Cleary's Langston. In this environment, companies have sought to put deals on the firmest possible footing with a lot of focus on how to creatively structure deals with cash, debt, and convertible instruments to avoid issuing enough shares to trigger a shareholder vote, he noted.

Pharmaceutical giant **Merck** [NYSE:MRK] completed its tender offer to acquire **Acceleron Pharma** in November despite some sellside shareholder opposition on valuation. Meanwhile, **Southwest Gas** [NYSE:SWX] closed a deal to acquire **Questar Pipeline** assets in December despite drawing criticism from Southwest activist Carl Icahn.

While M&A is still expected to be a key driver of activism in the year ahead, Barclays' Kerstein added that bumpitragage or deal opposition campaigns could become less aggressive as interest rates are set to rise amid an inflationary environment.

Cleary's Langston said he remained bullish on M&A through the first half of the year based on his firm's pipeline and the conversations they are having with board members and executives.

"Companies are still very confident on their strategic outlook and see this as an opportunity to reposition for this new environment, he said.

Private equity continues to have a "tremendous amount of dry powder," Morgan Stanley's Rosewater added. There will likely be a lot of sponsors chasing deals in the USD 1bn to USD 5bn size range, he said.

Meanwhile, antitrust scrutiny is expected to weigh on large-dollar M&A in the coming year, Rosewater and Barclays' Kerstein agreed.

### ESG in focus following Exxon contest

As activists adapt their tactics heading into the third year of the pandemic, their campaigns can be seen as a referendum on how companies have weathered the environmental and social issues highlighted in this period, said Ellen Holloman, a partner at **Cadwalader, Wickersham & Taft**.

Corporate focus on E&S issues has been building steadily over the years in line with institutional investor interest, some advisors previously told this news service.

Still, **Engine No. 1**'s success in installing new board members at **ExxonMobil** [NYSE:XOM] was a wakeup call to corporate America, said Cleary's Langston. ESG concerns may be just one battle within a broader proxy contest, but "it is one way to lose the war," Langston said.

Indeed, there has been a notable increase in corporate concern over environmental and social vulnerabilities, said Sidley's Zaba.

While traditional activists are unlikely to mount a campaign solely focused on an ESG issue, every company is only a couple of missed quarters away from raising investor concern about performance, and leaving ESG concerns unaddressed can exacerbate a company's situation in the event of a hiccup in performance, Zaba said.

Fundamentally, ESG will continue to be part of activism because activists are in the business of influencing shareholders and these issues have proven to be top of mind for large institutional investors, said Morgan Stanley's Rosewater.

Meanwhile, even as board diversity has certainly been a factor in some activist campaigns over the years, social issues have not "taken off" as much as investors' concern on environmental issues has, said Cadwalader's Holloman. However, many boardroom conversations on diversity have moved beyond a numbers game, focusing on more nuanced discussions on topics such as cognitive diversity, she said.

As investor scrutiny continues to gather around E&S issues, the Securities and Exchange Commission has also sought input on issues such as climate risk disclosure.

Overall, the Biden administration seems more willing to consider using the regulatory process to advance social goals compared to prior administrations of either party, said Christopher P. Davis, partner at Kleinberg Kaplan.

Still, the focus of investors and the Biden administration on advancing environmental and social priorities could face a backlash, Davis added, noting that history does not simply march in one direction.

### Eyes on universal proxy and other areas of SEC scrutiny

Some advisors highlighted that the implementation of the universal proxy card could impact future negotiations behind the scenes.

In November, the SEC approved rules requiring proxy cards in contested elections include all nominees. Compliance with the new rules will be required for elections after 31 August.

Dissident control slates are likely to be more difficult to successfully pursue under the single card system, Morgan Stanley's Rosewater said.

Control contests are an exception rather than the rule, and in the vast majority of activist situations, Sidley's Zaba believes that activists will be bolder in their demands with the universal proxy – including when negotiating an early settlement.

Once in effect, the rules may cause activists to believe they have a better chance to win several seats in contested elections, which could translate to activists demanding more than one board seat during settlement negotiations, possibly making settlements more difficult to achieve, said Richard Grossman, partner at Skadden, Arps, Slate, Meagher & Flom.

The universal proxy may even encourage more proxy fights where activists nominate a majority or full slate knowing that it allows institutional shareholders to support a few dissident candidates without handing them control, said MacKenzie's Burch.

The coming use of universal proxies will likely make it less expensive for a dissident to run a proxy contest because, while the new rules will impose minimum solicitation requirements on the dissident, in some cases, the dissident may be able to largely ride on the coattails of the company's solicitation efforts since the dissident's nominees will be on the company's proxy card, Gottfried said.

An activist may ultimately be tempted to move forward with the proxy contest, particularly for newer or smaller activists given the significantly reduced cost, said BofA's Daniels.

In preparation for the universal proxy, companies should re-examine their advance notice bylaws to ensure they address director nominations specifically, not just general business, Cadwalader's Holloman said.

Skadden's Grossman added that the new rules would have a minimal impact on advance notice deadlines, as a majority of companies' advance notice windows end before the deadline under the new universal proxy rules.

Ultimately, while the prospect of a universal proxy has been intensely discussed for a number of years, it is unclear whether it will have as big of an impact as some advisors believe, said Kleinberg's Davis. He believed it would quickly become the norm with both sides quick to adapt to the new regime.

Some corporate advisors are also looking to other areas of SEC focus with hope for reform on longstanding concerns about activist stake-building disclosure.

In December, the SEC proposed a rule that would require reporting of large security-based swap positions in the wake of the **Archegos Capital Management** trading fallout.

The proposed rule could close a "giant hole" in the current disclosure regime and make it more difficult for activists to evade existing disclosure requirements, said Sidley's Zaba.

Cleary's Langston agreed that the potential rule change was a step in the right direction, noting that he hoped it would pave the way for 13D reform.

### **Range of sectors, newly listed companies expected to be on activist radars**

In the year ahead, Morgan Stanley's Rosewater expected ESG pressure to continue weighing on the energy industry, while retailers will also continue to see investor pressure to unlock value by separating businesses. Innovation-oriented industries such as pharmaceuticals and technology are also likely to see activist interest, he added.

Meanwhile, activism in regulated industries, such as insurance and utilities, is also likely to continue, said Skadden's

Grossman.

Finally, following a record year of public listings, BofA's Daniels believes activists will be "sharpening their pencils" on the large cohort of newly public companies both in this year and the next.

Ultimately, Kleinberg's Davis cautioned against too much prognostication. Activism is still taking place as the world endures highly unusual health, economic, and social conditions, he noted, highlighting that modern-day activism has never seen inflationary pressures quite like what we face today, on top of major labor and supply chain disruptions, as well as social upheaval.

by Hanqing Chen

**Grade:** Confirmed

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## TARGETS

Macy's Inc

Kohl's Corp

Exxon Mobil Corporation

Royal Dutch Shell Plc

Vonage Holdings Corp

Southwest Gas Corporation

Zendesk, Inc.

SVMK Inc.

## BIDDERS

Ericsson

## OTHERS

Macellum Advisors GP, LLC

Engine Capital, LP

Engine No. 1 LLC

Jana Partners LLC

Third Point LLC

Mercury Systems, Inc.

Merck & Co., Inc.

Icahn Enterprises L.P.

USA

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Consumer: Retail

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**Topics:** Mergers and Acquisitions, Shareholder Activism

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**Intelligence ID:** intelcms-sb9vc4

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