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## Activists in the Boardroom: How to Prepare and Keep the Dialogue Productive

Rarely do companies pursue representatives from activist funds as board candidates, much less prepare for their arrival. Yet, increasingly activist shareholders are reaching the boardroom by winning proxy challenges or obtaining settlements that allow them to designate one or more board directors.



Chris Ruggeri

As a result, boards should consider making advanced preparations for the prospect of activist directors joining their ranks, with an eye to legal, operational and cultural considerations that may affect board room decision-making, such as potential bylaw and governance policy changes, disruptive impacts on employees and the possibility of conflicts among directors. “To some extent, shareholder activism is a debate over how to use capital and the issue can be approached in a constructive way,” noted Chris Ruggeri, principal, U.S. M&A leader, Deloitte Transaction and Business Analytics LLP, during a webcast hosted by Latham & Watkins.

Companies should consider developing a well-defined capital allocation process that is aligned with corporate strategy and is part of the regular board dialogue. If activists sit on the board, having in place an objective capital-decision framework with specific criteria allows the full board to discuss the relative merits of short- versus long-term strategies and alternatives.

“With the added perspective of an investor, the board may discover opportunities to enhance value by monetizing assets that are underperforming,” added Ms. Ruggeri.

### Productive, Not Disruptive



Mark Gerstein

According to webcast host Mark Gerstein, partner, Latham & Watkins and global chair of that firm’s Mergers & Acquisitions practice, the Delaware Court of Chancery has ruled that, in general, boards cannot seek to isolate an activist director from board deliberations; for example, by giving late notice of meetings or sending board materials at the last minute. However, there are steps boards can take prior to activists joining the board that may make board deliberations more productive than disruptive, including technical items related to bylaws.

For example, many company bylaws state that a board meeting can be convened by just one or two directors. “That’s not ideal when two activist directors join the board because it may allow abuse of board process by activist board members,” noted Mr. Gerstein. “We often suggest that boards amend bylaws so meetings have to be called by three or more or even a majority of the board, in addition to the chairman and company CEO.”

Board committee composition is another area to consider before activist directors join the board. For these smaller groups to be effective, existing board members should be well distributed among committees and the chair should be adept at managing the agenda and strategies of the group despite the possibility of less-than-conciliatory relationships with an activist. Further, committee chair selection should be made at the full board level, rather than within the committee.

Boards also should review policies pertaining to the authority of the chair and lead director. For instance, what is the role of the committee chair or lead director in shareholder communications? “Activist directors may have a different perspective on the appropriate level of information flow from and access to employees, and their requests can overwhelm management and disrupt and create uncertainty for the workforce. Having policies in place that allow the board as a whole or its chair to manage such interactions can be useful when activists are in the boardroom,” added Mr. Gerstein.

Developing director confidentiality policies also becomes more important as activist directors join the board. A board director who is appointed by a fund may have the ability, and should be expected to, report back to that fund on board information and dynamics, absent restrictions to the contrary. While the fund is responsible for maintaining confidential material and non-public information, the sharing of this information can constrain candor in the boardroom and adversely impact board decision-making.

## **Evaluating Board Nominees**

When vetting potential activist board members, existing boards should keep several criteria in mind to guard against settlement agreements that could give an unproductive director a seat on the board. “One of the more challenging aspects of evaluating board nominees is assessing whether new directors will be a cultural fit, particularly with respect to their style of decision-making,” said Ms. Ruggeri. For example, is the new director analytical and thorough or intuitive and impatient, and does that “style” complement the existing board? Other areas that help define a board’s decision-making style is its level of comfort with risk, and whether board members are open to constructive debate around strategic considerations and transaction opportunities.

In addition, boards should understand why an activist director is being nominated—to be a “monitor” or a “change agent,” noted Mr. Gerstein. A monitor often comes to the board as part of an agreement to enact a material change, such as a spin-off or a share repurchase, and sees that changes are implemented. A change agent is brought in to reorient, reset and refocus the board, either broadly or on an activist priority that may be different from those on which the board is focused. “Understanding the activist’s motivation for designating directors may inform the board’s view as to the most desirable qualities and expertise for such candidates,” added Mr. Gerstein.

The board also may want to evaluate a nominee’s independence under Delaware law and applicable stock exchange regulations, as well as whether the activist is an “independent thinker” in the boardroom and therefore willing to consider other points of view. “If the nominee serves on other boards at the behest of an activist shareholder, talking with legacy directors from that board may provide insight as to whether the nominee is a culture fit,” suggested Mr. Gerstein.

## **A Shareholder Engagement Plan**

“The focus of investors has shifted from a board-centric to a shareholder-centric environment,” noted Ms. Ruggeri. She explained that in the past, institutional investors were generally assumed to be passive and

often willing to follow the advice of proxy advisors. Today, investors regularly foster close working relationships and share information with activists, which is why boards should consider developing a comprehensive shareholder engagement plan. The plan should facilitate information-sharing and solicit feedback from the investment community about company and board performance. “Shareholder engagement should be a regular item on the board agenda so the perceptions of the investor community are considered,” noted Ms. Ruggeri.

Once activists join the board, their responsibilities change. They have a fiduciary duty to act on behalf of all shareholders—not just as a representative of a particular shareholder—and to stay informed and to act without conflict. “But as a practical matter, it is helpful to make clear to activist directors the financial objectives of the company, key metrics being tracked and that they, as new directors, are part of the dialogue,” observed Ms. Ruggeri.

## **Related Resources**

[Board Members: Are You Thinking Like an Activist Investor?](#)

[Shareholder Activism: How Will You Respond?](#)

[How Shareholder Activism Is Impacting CFO Searches](#)

[Six Actions Boards Can Take Toward Improved Risk Governance](#)

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