

# Directors & Boards

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## What to Do When an Activist Shows Up

Prior planning gives boards the best chance for success.

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Shareholder activism preparedness is integral to a board's oversight function. For most public companies, it is not a matter of if an activist investor will show up, but a matter of when. Activists will be fully prepared by the time they initiate a campaign, some with a legion of analysts and investigators armed to dismantle the company's strategy and exploit vulnerabilities. Public company directors should be equally ready.

### Preparation

Well before any outreach from an activist investor, the board should schedule periodic updates to review vulnerabilities. This includes a critical assessment of the company's financial performance, strategy and governance, with particular focus on board composition and structural defenses. Equally important is understanding the shareholder base, including voting, trading and arbitrage patterns, as well as any potential catalysts for volatility. Regardless of how an activist appears — through a seemingly innocuous email, a regulatory filing or even a public “Dear Chair” letter — directors can be tempted to hastily convene a meeting to convey their openness to hearing the investor's perspectives. Being responsive and establishing a line of communication is important, but the first step should be to alert the company's activism response team, which typically includes executive officers, legal counsel, a financial advisor, a public relations firm and a proxy solicitor. While most companies have advisors engaged and on standby, the response team should comprise seasoned activism specialists. Its first task is to help the company develop a “break the glass” activism response plan, which is centered around a list of tactical next steps that the company should take for various scenarios of escalation. Such plans also incorporate a communications outline with draft press releases, talking points and rebuttals to expected attacks. Astute boards will supplement such preparation with tabletop simulations to battle-test the company's representatives. Running into a meeting with an activist (or even a reluctant first-time active investor) without sufficient preparation can hamper the company's options and potentially give the activist useful soundbites.

### Engagement

Conventional wisdom holds that the best defense is a strong offense, and it holds true for activism preparedness. Companies with robust investor engagement programs are better positioned to deal with activist investors due to their insights on the depth of support for management across the shareholder base as well as the universe of criticisms. At first blush, a jittery board might suggest that the company take a confrontational approach and immediately reject an investor's critiques or misguided suggestions for the company. However, institutional investors and other stakeholders, including influential proxy advisory firms, assess a company's willingness to solicit and implement shareholder feedback. In addition to creating a weak record, blankly disregarding constructive input is often indicative of poor dynamics within the boardroom and company more broadly. Of course, an activist with self-interested criticisms or unrealistic demands should eventually be rebuffed, but it is important to do this respectfully and in a way that allows the company to later tell a compelling narrative about the engagement.

## Action

A strong offense also means getting ahead of investor expectations or changes in circumstances by taking decisive action. Boards can preempt concerns and alleviate pressure on management by spearheading changes prompted by new market conditions and implementing governance best practices in line with legal developments. In some situations, targeted enhancements can preempt an activist's criticisms and rebalance leverage; in other situations, investor uncertainty can be quelled by announcing strategic review initiatives (when appropriate) or adopting (realistic) long-range plans. Given that most activist campaigns include board composition demands, recognizing and addressing director vulnerabilities — including by removing long-tenured directors and adding new directors for their diversity of perspectives or to plug deficiencies in the board's collective skills — can moot an activist's criticism of the board. The added benefit of taking any of these actions proactively shows that the board is its own agent of change and deprives the activist the opportunity of taking credit. Timing is important and boards should have regular touchpoints with their advisors to solicit feedback on what the company can be doing to best position itself and when.

## Battle

Even companies who get most things right find themselves in the crosshairs of an inconsolable activist from time to time. What appears to be an ordinary engagement can eventually turn into a battle for votes at a company's annual meeting. No board should shy away from rejecting an activist's self-interested demands, but they are all advised to pursue a “dual-track approach” whereby they engage with an activist to reach a constructive (and possibly negotiated) outcome, while preparing for a contested election. Both sides usually prefer to avoid the cost, distraction and uncertainty of a proxy fight, but a large number of engagements devolve into just that each year. In certain situations, it may be appropriate to thwart an activist's rapid accumulation of shares by adopting a shareholder rights plan (a so-called “poison pill”) or other takeover defenses. Given that such tools are likely to be challenged when adopted in the face of an imminent proxy contest, a board should take steps to enhance the company's defensive profile on a “clear day” and as part of its regular cadence, ahead of any serious activism engagement. It is critical that a board seek guidance from its advisors and weigh the pros and cons of implementing such protections.

## Takeaways

Boards should be thoughtful about preparing the organization for shareholder activism, including by scheduling periodic training and response planning together with an experienced advisor team, implementing robust investor engagement practices, fostering a culture that encourages decisive actions and knowing what defensive tools and tactics are available to the company. While not a cure-all, successful outcomes are largely driven by board readiness.

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