Harvard Law School Forum on Corporate Governance

The Rise of the "Occasional Activist"

Posted by Spencer D. Klein and Tyler Miller, Morrison & Foerster LLP, on Wednesday, April 26, 2023

Editor's note: Spencer D. Klein is partner and Global Co-Chair of M&A practice and Tyler Miller is an associate at Morrison & Foerster LLP. This post is based on their Morrison & Foerster memorandum. Related research from the Program on Corporate Governance includes The Long-Term Effects of Hedge Fund Activism (discussed on the Forum here) by Lucian Bebchuk, Alon Brav, and Wei Jiang; Dancing with Activists (discussed on the Forum here) by Lucian A. Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch; and Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System by Leo E. Strine Jr.

The number of shareholder proposals put forward in 2022 increased by roughly 9% over 2021.[1] At the same time, however, the number of shareholder proposals put forward by hedge funds and dedicated activists went up by only 1%.[2] It appears that the rise in total proposals is due in part to "occasional activists" such as institutional investors and individuals, including company insiders. In the first half of 2022, first-time activists accounted for approximately 37% of all campaigns initiated in that time period, while some of the most familiar activist names such as Elliott Management, Icahn Associates, Pershing Square Capital Management, Starboard Value, and Third Point accounted for only 23%, representing levels of dedicated activist participation below those observed over the past five years.[3]

The Changing Face of Dedicated Activism

Returns for activist funds as a group were down significantly in 2022. The sector lost 17% in 2022, compared with positive returns of 16% in 2021 and 10.3% in 2020, according to HFR Inc.[4] Moreover, dedicated activists continue to struggle to consistently win board representation when proxy contests have gone all the way to a shareholder vote; of the 70 proxy contests that went to a shareholder vote in 2022, only 34 saw the activist shareholder win board representation.[5] Indeed, several large and prominent activists lost shareholder votes in 2022. For example, Starboard Value's campaigns for board representation at both Box, Inc. and Huntsman Corporation, and Ancora Advisors' campaign for board representation at Blucora, Inc., all failed, with the management slates being elected in full.[6]

In addition, the ability of activists to use environmental, social, and governance (ESG) concerns as a wedge issue in their campaigns – for several years an important tool for activists – may be

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[1] Deal Point Data.
[2] *Id.*
[3] The Activism Vulnerability Report | Q2 2022.
[4] Ronald D. Orol, *Ranking the Insurgents*, 40 Corporate Control Alert 11–12 (2023).
[5] FactSet.
[6] *Id.*

diminishing. There is recent pushback against ESG, with some arguing that it places too much emphasis on non-financial factors and can be harmful to shareholder value. This is primarily because ESG is extremely broad and can cover factors that are material to operations and risk as well as those that may not be tied directly to financial performance. Therefore, critics argue that this can result in lower returns for investors and may even harm the long-term sustainability of the company.[7] Another concern is that ESG ratings and criteria are often subjective and can vary widely depending on who is doing the rating. This can lead to confusion among investors and may make it difficult for companies to know how to best align with ESG expectations. Finally, some argue that ESG is a form of "greenwashing" that allows companies to appear socially responsible without actually making substantive changes to their practices.

A recent example of pushback by investors against an activist touting alleged ESG concerns was seen in Carl Icahn's 2022 proxy fight with McDonald's in which Icahn publicly criticized McDonald's for its suppliers' use of particular crates for pregnant pigs. McDonald's shareholders resoundingly rejected his director nominees and signaled that they were not at all convinced by his purported animal-welfare concerns.[8]

Several U.S. states are also lining up to diminish the impact of ESG. In 2021, Texas passed a law banning government agencies from doing business with firms that the state's comptroller claims are essentially boycotting fossil fuels such as BlackRock, the world's largest investment firm, and Florida also started pulling $2 billion of its money from BlackRock because of its positions in relation to certain of the firm's climate and social initiatives.[9] As of February 2023, Florida governor Ron DeSantis is proposing legislation to prohibit state and local governments from including any ESG considerations in investment decisions.[10] We note that the majority of the state level anti-ESG legislation is focused on climate change – and of the 130 pieces of legislation introduced in the past 2 years, about 22 have failed. Although many of the bills are pending, more of the legislation have failed than enacted.[11]

While we don't expect dedicated activists to disappear from the corporate landscape, Bill Ackman's 2020 announcement that he was abandoning his traditional activist investing strategy in favor of a more passive approach was particularly noteworthy. Ackman's Pershing Square Capital Management has been known for its aggressive campaigns to push for change. In a letter to investors, Ackman explained that he had come to the realization that his previous approach, which involved taking large stakes in companies and using his influence to effect change, was not always the best way to create long-term value for his investors. Instead, he said he planned to focus on investing in high-quality companies with strong long-term growth prospects and holding those investments for extended periods.

The Rise of the Occasional Activist

Taking the place of these dedicated activists are "occasional activists" like institutional investors and individuals, including company insiders. As institutional investors have grown in size, they

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[7] Some ESG factors – for example, anti-bribery, cyber and privacy – are directly tied to risk management and must be included within a company's compliance program.

[8] Carl Icahn loses proxy fight with McDonald's over animal welfare.

[9] The secret money fueling the conservative anti-ESG push.

[10] DeSantis expands anti-ESG push in crusade against 'woke' investing.

[11] This information is current as of March 30, 2023.

have become major shareholders in many companies, giving them a significant voice in corporate decision-making and greater leverage to push for changes they believe will benefit both the company and its shareholders. At the same time, the rise of online trading platforms and social media has made it easier for individuals to organize and advocate for changes in the companies they invest in. Directors and officers of publicly traded companies who are typically seen as being aligned with the interests of the company's management, have also become more vocal in their efforts to push for changes that they believe will benefit the company and its shareholders.

Occasional activism has taken many forms, including shareholder proposals, proxy contests, engaging with company management and board members, and publicly voicing concerns and recommendations. For example:

- **Neuberger Berman and NB Votes**: In 2020, Neuberger Berman, a large, diversified asset manager, established its NB Votes initiative in which it pre-announces its proxy-voting intentions on an array of voting topics that it believes will have material economic consequences for its clients. By telegraphing its voting intentions, NB Votes aims to promote better shareholder engagement and send a strong signal about the actions it would like certain companies to take.
- **David Hall and Velodyne Lidar**: In 2021, the founder of Velodyne Lidar, who had been ousted as chairman of the board earlier in the year, prevailed in a proxy contest and won a board seat. The heated proxy contest involved allegations of false statements and misconduct on both sides. Increased activism by insiders adds another dimension – these individuals are likely to have deep knowledge of the company and its operations, employees, risks, etc. These kinds of contests may also become more emotional and/or involve more personal attacks than others.
- **Engine No. 1 and ExxonMobil**: In 2021, hedge fund Engine No. 1 launched a campaign for changes in the strategy and leadership of ExxonMobil. Engine No. 1 sought to add four directors with experience in renewable energy and sustainability to the board, and to push the company to transition away from fossil fuels. The campaign was notable for the support it received from other institutional investors, including BlackRock and Vanguard, which signaled a growing willingness among institutional investors to engage in shareholder activism on environmental and social issues. Engine No. 1 was successful in its bid to elect two of its nominees, while the other two were narrowly defeated.
- **Aerojet Rocketdyne**: In 2022, the chief executive officer of defense supplier Aerojet Rocketdyne prevailed in a proxy contest against its executive chairman after the two had become embroiled in a bitter internal battle. The CEO's director slate received about 75% of the votes cast.
- **Neuberger Berman and Boeing**: In 2022, after engaging for several years with Boeing's senior management, board of directors, and sustainability team, Neuberger Berman successfully pushed the company to update and expand its Governance & Public Policy Committee's responsibilities to include formal oversight of environmental sustainability and climate change.
- **AIM Immunotech**: In 2022, AIM Immunotech successfully rejected the director nominees of Jonathan Jorgl and other members of an activist group that sought to take control of AIM's board of directors because their notice failed to disclose certain details as required by AIM's bylaws. This may indicate that, while occasional activism is increasing, some of these new activists' inexperience could pose difficulties for the success of their campaigns.

While these campaigns have not always been successful, it is clear that shareholder activism is increasingly being conducted by institutional investors and individuals who are not in the full-time business of activism. This trend is also likely to accelerate further now that the amendments to the proxy rules adopted by the U.S. Securities and Exchange Commission requiring the use of a "universal proxy card" have become effective.[12] With shareholders able to cherry-pick nominees from competing slates, it seems more likely that dissidents will win minority representation. Shareholders who were previously reticent to use all of their votes on a short slate of director nominees can now make use of all of their votes by using some for the dissident's short slate and some for company nominees.

It is also possible that dissidents will be more likely to nominate short slates rather than full slates and continue the trend of nominating industry experts with extensive qualifications instead of the activist's employees or affiliates. On the other hand, the shareholders' ability to pick and choose from both proxy cards may make it less likely for dissidents to succeed in electing a majority of the board unless shareholders perceive the need for radical change or the dissident is proposing an acquisition favored by the shareholders. Although the universal proxy card may not materially affect an established activist investor's willingness to commence a proxy contest, the enhanced ability to elect a minority slate might be attractive to smaller, newer, or occasional activists who might have otherwise shied away from the expense and resource requirements of a proxy contest, given the uncertain outcome.

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[12] Preparing for the Mandatory Universal Proxy Card and Its Potential Impacts on Shareholder Activism and Proxy Contests.