

Activist investors: a dialogue with Harlan Zimmerman, Cevian Capital

On 8–9 April 2015, the European Audit Committee Leadership Network (EACLN) convened in London for its 23rd stand-alone meeting. One session was a dialogue with Harlan Zimmerman, a senior partner of Cevian Capital, Europe’s largest activist fund and one of the largest activist funds globally.¹ For a biography of Mr Zimmerman, including background information on Cevian, see Appendix 1 on page 12. For a full list of participants, see Appendix 3 on page 14.

Executive summary

Mr Zimmerman and EACLN members touched on three topics:²

- **Trends in investor activism** (*page 1*)

Mr Zimmerman explained that among investors dedicated to activism, there is a spectrum between “attackivists,” who use adversarial tactics to pursue short-term gains, and “constructivists,” who use collaborative approaches and in-depth research to help companies achieve long-term success. In the European context, a variety of factors, such as concentrated ownership, more extensive shareholder rights, and a more polite business culture, have tended to make adversarial tactics more difficult but also less necessary in the effort to influence companies.

- **Company responses to activism** (*page 6*)

EACLN members and Mr Zimmerman remarked on the measures companies can use to prepare for and respond to an activist intervention. It is critical for a company to understand its long-term shareholders and the issues that might draw the “*wrong type*” of activist interest. Companies should also prepare a response plan and a team that includes external advisers. If an activist approaches the company, management and the board should evaluate the activist and their case with an open mind. Mr Zimmerman also suggested some approaches to understanding what sort of activist the company is facing, such as requesting references and asking about holding periods and past board experiences.

- **Activist investors on the board** (*page 9*)

Activists often ask for seats on the board, though Mr Zimmerman noted that the acceptance of activists joining the board varies from country to country. EACLN members pointed out that having a constructive activist on the board can bring significant benefits in terms of resources and knowledge, withstanding short-term pressures, and bolstering the board’s ability and willingness to challenge management. However, a member suggested that, to maximize these benefits and prevent information asymmetries on the board, the information that flows between the activist and management should include the whole board.

For a list of discussion questions for boards and audit committees, see Appendix 4 on page 15.

¹ In another session, EACLN members discussed cybersecurity. See European Audit Committee Leadership Network, TITLE AND LINK HERE, *ViewPoints* (Waltham, MA: Tapestry Networks, 2015).

² *ViewPoints* reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

Trends in investor activism

In the last several years, investor activism has emerged as a major topic of interest in the business community in Europe and the United States, as well as in other regions. Activism by investors is increasing, as indicated by a variety of measures. And as observers and activists themselves suggest, it is also evolving in terms of the targets, objectives, and strategies chosen by activists. The situation is more complex than in the past, leading companies to review their responses to actual and potential interventions by activists.

A spectrum of activist investors

The changing scene prompted EACLN members to note in pre-meeting conversations that clarity around basic concepts would be helpful. A member remarked, *“We need to decide up front what you call an activist. Multibillion-dollar hedge funds? Institutional investors? Wealthy individual investors?”* At the meeting, Mr Zimmerman defined activists as investors who arrive with a plan to do something, not investors who intervene more reactively or defensively. This definition includes hedge funds devoted to a strategy of active investment, but not institutional or individual investors with governance teams who occasionally decide to intervene in one or more of the companies they own (normally in response to a negative event). Mr Zimmerman went on to explain that within this group of *“dedicated activists,”* there is a spectrum of players between two poles:

- **Short-term “attackavists.”** These types of activists seek quick gains using adversarial strategies such as proxy fights, media campaigns and lawsuits. As Mr Zimmerman noted, they are often *“focused on putting the company in play or getting money out,”* and they are most active when *“the world is buoyant – when there’s a lot of capital available and a lot of M&A happening – because that’s when they have a greater chance of forcing an issue.”* In many people’s minds, “activist investor” is synonymous with this type of investor, often referred to as a “corporate raider.”
- **Long-term “constructivists.”** These activists have a longer time horizon (typically 3-5 years), and their strategies are more collaborative with companies and aligned with the interests of other shareholders. Instead of dividends or buy-backs, they are more oriented around improvements designed to create long-term fundamental value, such as operational and strategy/structure improvements. As Mr Zimmerman explained, they look at a company with a clean sheet of paper and ask, *“If we owned 100% of this company, what would we do to create maximum value over the long-term?”*

Both short-term and long-term activists may seek sizeable holdings in a company, but activists need not be major shareholders. The source of an activist’s power is not only its own votes as a shareholder, but its ability to persuade other investors to support its objectives (whether they result in a vote or not). Thus, even shareholders with a stake as small as 1% or less can be activists if they have sufficient credibility and can exert influence on larger institutional, family or foundation shareholders. For some examples of activist interventions, see Appendix 2 on page 13.

Increasing activism

Visible activist interventions increased 88% between January 2010 and September 2013, with the majority of that growth in Europe and the United States.³ Assets under management at activist hedge funds increased from less than \$12 billion to more than \$100 billion during the same time period,⁴ and they reached \$150

³ Linklaters, *“Activist Investors Turn Up the Heat in Global Boardrooms,”* news release, 11 November 2013.

⁴ Cal Smith, *“Responding to the New Shareholder Activism,”* King & Spalding Directors Governance Center, 4 December 2013.

billion by 2014.⁵ Mr Zimmerman noted that much of the new money has gone into just a few of the long-established and larger funds (such as Pershing Square Capital Management, ValueAct Capital, Trian Partners and Cevian itself).

The targets of these funds are not just smaller companies in which it is easier to acquire a sizeable ownership stake: since January 2010, activist investors have stepped up their actions by 129% at companies with \$2 billion or greater market capitalization.⁶ For many observers, the ability of ValueAct Capital to secure a seat on the board of Microsoft in 2013 – despite the fact that it had a stake of only 0.8% – was a watershed moment, indicating that no company was immune to activist intervention.⁷

What are the drivers for this surge in activism and the flow of money into activist funds? Observers point to the impressive returns of some activist funds – though this success may also reflect the bull market of recent years and returns also vary significantly across funds.⁸ Other observers highlight the increasing levels of cash on corporate balance sheets, which present an appealing target for activists seeking higher dividends or share buybacks.⁹

Another factor may be the increasing support from institutional investors, who are not only putting more money into activist funds but are also aligning with them on specific campaigns where they own shares themselves. In the words of one commentator, “Supporting activists has largely lost the stigma that it had among traditional institutional investors, which once may have viewed activists as a disruptive influence acting contrary to the long-term interests of the company, but today view activist investors as a useful tool.”¹⁰ Mr Zimmerman noted that over the years, the portfolios of institutional investors have become more diversified and index-oriented, meaning that the investors have less incentive to directly engage with companies, and the companies have shareholder bases that are often highly fragmented and faceless. This has created an ownership vacuum at many companies. Activists fill this vacuum where they believe doing so can create value. There is a symbiotic relationship among activists and institutional owners, since the work of activists benefits from the support of other owners, and the other owners benefit from the work of the activists.

The approach used by constructive activists

The prevalence of activists that take a more constructive, long-term approach may be increasing. These activists seek to work with the board and management to improve strategy, structure and/or operations, persuading them that the changes the activists are seeking are in the interests of the company and its shareholders. Cevian Capital is seen as this kind of activist, and Mr Zimmerman highlighted several aspects of the firm’s approach:

- **Constructive intervention.** The firm does not short, hedge, use leverage or publicly attack companies, focusing instead on constructive dialogue with companies that have potential to improve long-term value

⁵ Marc Weingarten and David E. Rosewater, “The era of activism,” in *Activist Investing: An Annual Review of Trends in Shareholder Activism* (London: Activist Insight Ltd., 2015), page 5.

⁶ Linklaters, “Activist Investors Turn Up the Heat in Global Boardrooms.”

⁷ “Microsoft Offers ValueAct President Seat on Board,” *Reuters*, 30 August 2013.

⁸ Stephen Foley, “Activist Investors’ Success Owes Much to Wider Bull Run,” *Financial Times*, 2 March 2015.

⁹ Jeffrey Green and Beth Jinks, “Icahn’s EBay Talks Show Boards Listening to Activists,” *Bloomberg*, 23 January 2014.

¹⁰ Stephen F. Arcano and Richard J. Grossman, “Activist Shareholders in the US: A Changing Landscape,” *Harvard Law School Forum on Corporate Governance and Financial Regulation* (blog), 28 June 2013.

by enhancing operational performance, corporate strategy and structure, and corporate governance.¹¹ The firm does not publish white papers or publicly “shame” companies by using the media. As Mr Zimmerman explained, *“Our PR firm mostly works to keep us out of the press. We feel that press coverage can polarize, which can make it harder for companies to greet our initiatives. Additionally, to maximize long-term value, we want to build, not diminish, the credibility of the company and its governance.”* Increasingly, constructive investors are being invited into companies by management and boards when they are looking for help in catalyzing change.

- **Emphasis on deep, fundamental research.** Mr Zimmerman noted that the firm typically spends at least six months researching a potential investment, often meeting with and speaking to 100–150 different individuals at and around target companies (for example, competitors, customers, suppliers) to understand companies’ fundamentals and value-enhancement potential. This approach *“normally leads us to companies whose fundamentals are underpinned by blue-chip businesses, but where the company overall has fallen out of favor, has become misunderstood, or is facing difficult challenges that concern a market that is increasingly short-term focused.”*
- **Longer time horizons.** Recognizing that it may take many years to implement significant changes at a company, the firm has a three-to-five-year investment horizon and seeks to support companies in prioritizing the long term over the short term.

These points echoed remarks made by Mason Morfit of ValueAct Capital, who met with members of the North American ACLN in March 2014. Mr Morfit, the activist investor who joined the board of Microsoft, emphasized the focus and depth of his firm’s research, noting that the firm holds only 10 to 18 core investments at a time. Explaining how the firm developed its approach, he remarked, *“We learned that boards don’t like being told what to do on TV. Business is done through personal relationships.”*¹²

The European context

A more discreet, cooperative approach may be particularly suited to the European context. Experts on activism have pointed to several ways in which Europe in general is different from the United States as an environment for activist intervention by shareholders, and Mr Zimmerman confirmed many of their observations:

- **Separate CEO and chair.** Combining the roles of the CEO and the chair of the board is far less common in Europe than in the United States, which means that the CEO in European companies has less control over the board and less ability to block activist interventions.
- **Rights to nominate directors.** The addition of board candidates to the company proxy statement by shareholders is more common in Europe than in the United States, where Securities and Exchange Commission rules have until recently made it easier for companies to exclude such proposals.¹³ The issue of proxy access to nominate directors is now under debate in the United States and some companies are beginning to provide it.

¹¹ Cevian Capital, *“Strategy.”* accessed 6 March 2015.

¹² Audit Committee Leadership Network, *Dealing with Activist Investors*, ViewPoints (Waltham, MA: Tapestry Networks, 2014), page 5.

¹³ Luc Renneboog and Peter Szilagyi, *“Shareholder Engagement at European General Meetings,”* in *Boards and Shareholders in European Listed Companies*, ed. Massimo Belcredi and Guido Ferrarini (Cambridge: Cambridge University Press, 2014), page 327.

- **Rights to call a shareholder meeting.** Many European jurisdictions also allow shareholders with a certain percentage of voting capital (often 5%) to call an extraordinary general meeting, a right that in the United States must be granted by the company's articles of association.¹⁴
- **Binding shareholder proposals.** Unlike in the United States, proposals that pass a shareholder vote are legally binding in the United Kingdom and most of continental Europe, giving leverage to activists in negotiations with the company.¹⁵
- **Concentrated ownership.** In Europe shareholder registers are normally more concentrated than in the US. Mr Zimmerman noted that this often makes it easier for activists and companies alike to “do the math” without resorting to a public campaign to determine support levels. At the same time, many large, publicly listed European companies are backed by an “anchor shareholder” such as a family, a foundation or a few large shareholders, which may discourage attempts by other shareholders to influence the board.¹⁶ Indeed, Cevian often acts as an anchor shareholder itself.
- **Business culture.** Some activist strategies that are common in the United States are less acceptable in Europe, which observers note has a “less rambunctious corporate culture.”¹⁷ As one observer remarked about legal tactics in particular, “If you are an American activist you will have lawsuits running for the next 10 years. In Europe you never sue people: how desperately impolite.”¹⁸ Mr Zimmerman noted that in European business circles legal remedies are normally seen as a last resort, while America is often considered the most litigious country in the world.
- **Stakeholder-oriented governance regimes.** Even though shareholders often have more formal powers in Europe than in the United States, other stakeholders such as employees and creditors may have representation on the board in some countries.¹⁹ These stakeholders may share some objectives with long-term oriented shareholders, but they may also have conflicting views, potentially shaping activist strategies.

In an effort to increase shareholder engagement in Europe, the European Union's Shareholder Rights Directive of 2007 sought to strengthen shareholders' rights and remove or lessen some of the difficulties associated with engagement. Its key provisions included such elements as abolition of share blocking, minimum standards on sharing information with shareholders, and minimum standards on shareholders' rights to ask questions, put items on the general meeting agenda, and table resolutions.²⁰

As many observers have argued, the characteristics of the European environment lend themselves to an activist approach that relies on private engagement and collaboration rather than on adversarial campaigns.²¹ Activist interventions in Europe are often resolved before they become public, which may be one reason that activism – especially of the adversarial kind – is still viewed as chiefly an American phenomenon.²²

¹⁴ Marco Becht, Julian Franks, Jeremy Grant, and Hannes Wagner, “The Returns to Hedge Fund Activism: An International Study,” *European Corporate Governance Institute (ECGI) – Finance Working Paper No. 402/2014*, 2 March 2015, page 12.

¹⁵ Luc Renneboog and Peter Szilagyi, “Shareholder Engagement at European General Meetings,” page 320.

¹⁶ *Ibid.*, page 321.

¹⁷ Shayndi Raice, “Investor Activism in Europe Attracts U.S. Advisers,” *Wall Street Journal*, 27 April 2014.

¹⁸ Laura Board, “Europe Girds for an Activist Onslaught,” *The Deal Pipeline*, 25 April 2014.

¹⁹ Luc Renneboog and Peter Szilagyi, “Shareholder Engagement at European General Meetings,” page 321.

²⁰ European Commission, “Corporate Governance: Directive on Shareholders' Rights Formally Adopted,” news release, 12 June 2007.

²¹ Shayndi Raice, “Investor Activism in Europe Attracts U.S. Advisers.”

²² A recent overview by the *Economist* said that 80% of activist interventions take place in the United States. See “An Investor Calls,” *Economist*, 7 February 2015.

According to Activist Insight, however, more than 100 companies have been publicly targeted in Europe since 2010, and these campaigns may represent less than one-third of all engagements.²³

At the level of individual European nations, there are variations that can also influence activists and their impact. Each country has its own corporate governance regulations, unwritten rules of conduct, board and management networks, and local institutional owners – so the local context is important and Europe should not be seen as a single “activism market”:

- In the United Kingdom, deeper and more liquid capital markets, combined with a strong focus on investor stewardship and shareholder value, have led to much more activism there than in continental Europe.²⁴
- In France, the so-called Florange Law, approved in 2014, allocates double voting rights for shares held for more than two years (unless these rights are specifically denied in the company constitution), which may be useful to some activists but not others.²⁵ The level of government involvement in companies can also act as a barrier to activist engagement. There are also variations across Europe in the regulation of shareholder proposals and proxy solicitations, which can influence the incentives and costs faced by activists.²⁶

As Mr Zimmerman noted, in some European countries (for example, Germany and Sweden), there is a tradition of “anchor shareholders,” and this concept fits with longer-term, constructive activism and has benefits for companies as well as shareholders: *“Companies with anchor shareholders don’t have to wonder what shareholders are thinking, because they have at least one big shareholder who stands shoulder-to-shoulder with them. We are also in a position to tell our companies, ‘don’t worry about the short term, focus on what creates value in the long term’ or, we should increase management incentives and we’ll be the lightning rod for that.”*

Company responses to activism

EACLN members expressed a strong interest in understanding activism and its implications for their companies. Though many companies in Europe have not been directly targeted, at least some of them are actively trying to prevent and prepare for an activist intervention. Where companies have actually been targeted, the differing objectives and strategies of the activists may require a mix of responses.

Preparing for an activist intervention

Several EACLN members underscored that advance preparation is important, not only to enable an effective response to an intervention but to prevent it in the first place, if possible. One member remarked, *“When an activist is on your doorstep, it’s too late. We need to convince boards that there is a real danger. Currently, there’s no sense of urgency to get organized.”* Experts on handling activists agree, as did North

²³ Activist Insight, “Forward,” *Activist Investing in Europe: A Special Report* (London: Activist Insight Ltd., 2014), page 3.

²⁴ Scott Hopkins and Lorenzo Corte, “Shareholder Activism – Recent Developments in the UK,” in *Activist Investing in Europe: A Special Report* (London: Activist Insight, 2014), page 5.

²⁵ Armand Grumberg and Pascal Bline, “Florange Law: Its Potential Impact on Shareholder Activism in France,” in *Activist Investing in Europe: A Special Report* (London: Activist Insight, 2014), page 7.

²⁶ Luc Renneboog and Peter Szilagyi, “Shareholder Engagement at European General Meetings,” page 327; For more detail on shareholder rights in shareholder meetings and board elections, see Marco Becht, Julian Franks, Jeremy Grant, and Hannes Wagner, *“The Returns to Hedge Fund Activism: An International Study.”* page 32 and 33 (January 2014 version).

American audit chairs when they discussed activism with an expert from Teneo Strategy in March 2014.²⁷ That discussion yielded several recommendations, mentioned in some cases by European audit chairs as well:

- **Think like an activist.** Boards need to keep the company strategy under continuous review and consider how the company is performing against its peers and the market as a whole, as well as its own potential. One member said, *“Our reaction is that boards should become activists themselves, long-term vision activists.”* But the member also highlighted the challenge involved: *“We need to improve our game. What resources do we need to do that? Being an audit committee chair is my full-time job. But I don’t have a research team ... Boards should be given the resources to improve their game.”*
- **Assess and address vulnerabilities.** Companies should try to identify the characteristics of a company that draws interest from activists and then do something about it. One EACLN member said, *“What characterizes a company that ends up with a set of activist shareholders? None of us want to be there. The best defense is prevention. We want to know how not to be in that situation in the first place.”* As another member pointed out, understanding the company’s vulnerabilities also means understanding activists’ perceptions of those vulnerabilities: *“What do they expect a company to do? What is constructive? What would make them feel a company knows what it is doing?”*

Red flags that might draw the attention of activists include poor operating performance or shareholder return, unplanned senior management departures, significant litigation and operational mishaps.²⁸ Perceived weaknesses of the board itself, such as its composition and the tenure of its members, can also be a factor.²⁹

- **Know your investors.** Understanding major shareholders and maintaining good relationships with them allows a company to lay the groundwork for calling on them for support, and it means the company is more likely to identify concerns that might push investors to support an activist.³⁰ A member said, *“We know our shareholders well. I believe in putting in a lot of work in building the right shareholder base and communicating with them well.”* Keeping track of the trading patterns of the company’s shares can also reveal an emerging activist intervention. Ensuring that the shareholder base is aligned with the company’s strategy is critical and may require a concerted effort to attract a different kind of shareholder.
- **Prepare a plan and a team.** Companies should think through how they would respond if an activist intervened, keeping in mind that an aggressive attack could precipitate a crisis requiring speedy action. One member remarked, *“In most big companies, they have action plans they can dust off in the event of a hostile takeover bid. And that’s probably the closest you’ll get to it: something they can dust off quickly if they have an activist approach.”* Companies can also determine in advance who would be part of the response team, including external advisers such as bankers, lawyers and communication specialists.
- **Consider relationships between directors and investors.** The board itself can develop relationships with major investors, and board members may already have such relationships from previous experiences with activists on other boards, which can help. This strategy prompted mixed responses from audit chairs

²⁷ Audit Committee Leadership Network, *Dealing with Activist Investors*, page 7.

²⁸ Tapestry Networks, Cadwalader, Wickersham & Taft LLP, and Teneo Holdings, *SDX: The Shareholder-Director Exchange: Introduction and Protocol* (Tapestry Networks, Cadwalader, Wickersham & Taft LLP, and Teneo Holdings, 2014), page 3.

²⁹ See EY Center for Board Matters, *Getting It Right: Succession Planning for the Boardroom and C-Suite*, Let’s Talk: Governance, no. 3 (London, Ernst & Young LLP, 2014).

³⁰ Lead Director Network, *Dealing with Shareholder Activism* ViewPoints (Waltham, MA: Tapestry Networks, 2014), page 5.

during the ACLN discussion of activism. Some saw it as a promising way of increasing understanding, while others saw it as having the potential to undermine management.

Responding to an activist challenge

Experts on activism and both EACLN and ACLN members agree that when an activist actually targets a company, management and the board should respond in a measured way that starts with a clear understanding of the activist's objectives:

- **Engaging with the activist.** An EACLN member said, *“Don't block activists out. The board chair should meet with them and listen. There should be flexibility in response. There should be a dialogue. There should be an exploration to see if the weaknesses pointed out by the activist are valid. The worst thing to do is to block them and not to speak with them.”* This advice echoed the views of ACLN members, who underscored the importance of being “brutally honest with yourself about what you are hearing.”³¹ Mr Zimmerman suggested that boards also ask the activist a few questions about the activist firm itself in order to understand their real nature: What are their average and longest holding periods? Do they short companies? How many board seats have they held in the past? Can they provide as references three chairman from companies where the firm has previously been active? If they joined the board, would they accept restrictions on their activities, such as stock trading restrictions and confidentiality and non-disparagement agreements?

Regarding the role of the board in engaging with activists, however, one member suggested, *“Only the board chair should engage with the activist. Other board members, like the audit chair, should advise the board chair on how to evaluate and respond to the activist, but among board members, only the chair should be directly engaged with the activist.”*

- **Reaching out to other shareholders.** As soon as possible, the company should meet with its major long-term shareholders to explain the situation and gauge their views. Institutional investors have told Tapestry that companies are often too slow to reach out and that, by the time they do, investors have often already decided whether to back the activist campaign. Understanding how much support the activist has may help in the negotiations. It is at this point that the relationships established with shareholders become very important. An EACLN member recounted how, after an activist approached their company demanding cash, the company consulted with shareholders and settled on a share buy-back that satisfied both the activist and the other shareholders.
- **Resisting the activist.** If engagement with the activist is not appropriate or fails to lead to a satisfactory outcome, companies may need to stand firm. This will often involve a multipronged campaign that includes working with proxy advisers to garner their support, managing the company's image in the media, and employing whatever legal defenses are available or necessary in response to the activist's legal tactics.

A member remarked on the benefits of external advisers in responding to an activist challenge: *“[They] kept tabs on how much [the activist] had and who he was lobbying to come along. It's good to have advisers because it takes the emotional stuff out of it.”* Another member pointed to a specific role for the audit committee: *“We are the analytic arm regarding what should be done by the board.”*

³¹ Audit Committee Leadership Network, *Dealing with Activist Investors*, page 7.

Activist investors on the board

Sometimes the outcome of an activist intervention is that the activist secures a seat on the board, either through a negotiated settlement or through a contested election in which the activist has managed to secure the support of institutional investors, aided perhaps by the support of the proxy advisory firms. In Europe, gaining board representation was the objective of 28% of activist campaigns between 2010 and 2013.³² Mr Zimmerman noted that Cevian team members currently hold 10 board seats in companies in six European countries, and the receptivity to taking a seat on the board varies from country to country: *“It’s more common in Germany, Switzerland and the Nordics, where there isn’t a stigma about having an owner on the board, than in the UK.”*

In pre-meeting conversations, a few EACLN members pointed out the potential benefits of having an activist on the board. A member remarked, *“Activist investors have access to a lot of information from their activities, which makes them much more valuable as directors.”* Another member elaborated on the subject, referencing the European context: *“In the EU, there are strong shareholders in many companies, and that is risky. The controlling shareholders and management become auto-referential. It’s the same group with the same interests – there is no new life on the board. An activist investor has resources and capabilities to provide [a] real challenge to management, which is not often seen on boards.”*

These views were similar to some of the perspectives that emerged in the ACLN’s discussions of activist investors. Making his case to the audit chairs, Mr Morfit, of ValueAct, said, *“We represent a form of diversity. We have nothing to do but follow the company.”* He noted that when he joined his first board at the age of 27, *“I couldn’t say I had run a company. But I had done the analysis, listened to competitors’ conference calls, attended trade shows, etc.”*³³

³² J.P. Morgan Mergers & Acquisitions Group, *Knocking on the Door – Shareholder Activism in Europe: Five Things You Need to Know* (New York: J.P. Morgan Mergers & Acquisitions Group, 2014), page 8.

³³ Audit Committee Leadership Network, *Dealing with Activist Investors*, page 9.

American board directors on working with activist board members

At a March 2014 meeting of the US-based Lead Director Network (LDN), several lead directors and non-executive chairs recounted their experiences with an activist board member. The following is an excerpt from the associated *ViewPoints*:³⁴

As boards and management have become more open to listening to activists, LDN members have come to appreciate the benefits that some activists provide. In one member's experience, the activist *"Became a really great director and went on to chair a board committee."* Another described how the board wanted the activist director to stay even after the activist fund sold its investment in the company. Another member said that activist directors can help act as a catalyst for change: *"We never could have changed the CEO pay package without [the activist] pushing. I give him a lot of credit – he said, 'Make me the bad guy.'"*

However, not every activist director is helpful. One LDN member said that the wrong activist *"Can be disruptive,"* and described a situation where a *"One-sided"* activist joined the board, with negative consequences: *"Before, the board trusted each other. When someone came in under different circumstances, the board clammed up."*

Other members noted the more general benefit of having an investor on the board, whether an activist or not: *"On one board, we have a member who is a hedge fund manager who has been wildly informative to the board, telling us what investors would think about [certain actions]."*

At the same time, both EAACN and ACLN members raised some specific concerns with regard to activists who serve on the board.³⁵ For example, an activist may be inclined to go directly to management to seek or provide information, creating information asymmetries by leaving the rest of the board out of the loop. Some members felt that protocols need to be established such that these exchanges of information include the whole board. As a member remarked, *"An activist can have intellectual superiority because of the analytical resources available to them, but they need to build trust with the other directors or they will be a lonely person."* Mr Zimmerman noted that the arrival of an activist may ultimately result in significant improvements in management's reporting to the board.

Members also noted that exposure to insider information could be awkward for an activist, particularly one with a short-term time horizon. In Europe, the recent revisions to the EU's market abuse regime strengthen the prohibitions against insider dealing and improper disclosure of inside information.³⁶ One solution may be the appointment to the board of a mutually satisfactory independent director rather than the activist.³⁷ Clear criteria for nominating and electing board members can help boards ensure that the new member is acceptable.³⁸

³⁴ Lead Director Network, *Dealing with Shareholder Activism*, page 9.

³⁵ Audit Committee Leadership Network, *Dealing with Activist Investors*, page 10.

³⁶ See Cleary Gottlieb, *MAD II Adopted by European Parliament and Council*, Alert Memorandum (New York: Cleary Gottlieb, 2014).

³⁷ Audit Committee Leadership Network, *Dealing with Activist Investors*, page 11.

³⁸ Lead Director Network, *Dealing with Shareholder Activism*, page 8.

Conclusion

Mr Zimmerman underscored that activist investors today include not only the short-term corporate raiders feared by boards and management, but also constructive activists that generate returns by supporting companies in achieving long-term success: *“What we’re doing in many cases is providing an underpinning for the company to take better long-term decisions and long-term actions.”* These activists take a constructive approach supported by extensive research. Their approach may be particularly suited to the European context, where a variety of factors render adversarial approaches more difficult and also less necessary. To prepare for and respond to an activist intervention, EACLN members and Mr Zimmerman agreed: Companies should get to know their major long-term investors and understand the issues that might draw an activist’s interest. When an activist approaches, a company should evaluate the activist and the validity of the activist’s case with an open mind. Allowing an activist to take a seat on the board can bring important benefits, especially if information exchanges include the whole board.

About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Biography of Harlan Zimmerman

Harlan Zimmerman is a senior partner of Cevian Capital, with responsibilities across investment, engagement, and business matters of the firm. He is based in London and has worked with Cevian since 2003.

Cevian is Europe's largest active ownership, or "activist," manager, with approximately €13 billion dedicated to constructive activist investing in listed European companies. Cevian is long-only, does not use leverage, and has a typical holding period of 4–5 years (backed by an institutional capital base committed for a similar term). Cevian's 25 investment professionals focus on approximately 12 portfolio companies at a time (with ownership stakes of approximately 5%–25%) and work to add value through hands-on, constructive ownership. Its focus is primarily on operational and strategy/structure changes, rather than on financial engineering. Most of Cevian's senior team members have consulting or private equity backgrounds, and Cevian's professionals often join portfolio company boards directly (collectively they have held approximately 40 board seats in Denmark, Finland, Germany, Norway, Sweden, Switzerland, and the United Kingdom). It often plays the role of "anchor investor." Cevian has never had a proxy fight or publicly attacked a company. Cevian has offices in Stockholm, Zurich, and London, where its founders began implementing the firm's strategy in 1996.

Prior to Cevian, Harlan was a partner at Capital Z Investment Partners, a sponsor of private equity and hedge funds. Previously, he managed listed equities and private equity at F&C Management (then Foreign & Colonial), and was a project financier at Morgan Grenfell. Harlan attended the Lauder Institute of the University of Pennsylvania, where he earned an MBA in finance from Wharton and an MA in international relations. He earned a BA in international relations and Russian from the University of California, Davis. He is a dual US/UK citizen and has lived in London since 1992.

Appendix 2: Examples of activist interventions

Many of the most well-known activist interventions have taken place in North America, such as the campaign by Pershing Square Capital Management to remove the CEO, the chair, and several other board members at Canadian Pacific Railway. The following are examples of interventions in the European context, which are often (but not always) less draconian:

- **Elliott Management secures higher bid for Celesio.** When McKesson, a US-based healthcare services provider, tried to buy the German company Celesio in late 2013, Elliott campaigned publicly to get a better price for the convertible bonds it held. Elliott succeeded, though another hedge fund, Magnetar Capital, subsequently sued McKesson for discriminating against minority shareholders, a violation of German takeover laws.³⁹
- **Findim Group forces resignations from Telecom Italia board.** With a 5% stake, Findim sought to replace the entire board of Telecom Italia in late 2013. Findim lost the shareholder vote, but the battle was close enough to cause two representatives of Telecom Italia's largest shareholder to resign before the shareholder meeting.⁴⁰
- **Cevian Capital joins the board at ThyssenKrupp.** In the spring of 2014, Cevian increased its stake in ThyssenKrupp to more than 15%, and by the end of January 2015, one of its professionals had joined the supervisory board. Though some observers have speculated that Cevian could increase pressure for a spin-off of ThyssenKrupp's European steel business, Cevian has thus far supported management.⁴¹
- **Knight Vinke Asset Management agitates for divestment at UBS.** Knight Vinke took a 1% stake in UBS and sought to convince the bank to spin off its investment banking division, first through private engagement, but then by issuing a public letter. UBS has resisted so far.⁴²
- **TCI urges Airbus to sell its Dassault stake.** In August 2013, the Children's Investment Fund (TCI) wrote to Airbus Group (then EADS, in which TCI had a 1% stake), asking it to sell its 46% stake in Dassault Aviation. Airbus and Dassault now plan to complete the sale by the end of 2015.⁴³
- **Gotham City exposes fraud at Gowex.** In the summer of 2014, short seller Gotham City Research released a report documenting extensive financial fraud at the Spanish technology company Let's Gowex. As a result, the share price collapsed, the CEO resigned, and the company filed for insolvency. One of the first clues Gotham City focused on was the fee that Gowex paid its auditor, which was very low relative to the company's purported revenue.⁴⁴

³⁹ Chad Bray, "[Hedge Fund Sues McKesson Unit Over Celesio Deal](#)," *New York Times*, DealBook, 21 May 2014.

⁴⁰ Pascal Bine et al., "[The New Barbarians – Shareholder Activists Have Europe in Their Sights](#)."

⁴¹ Chris Bryant and Sam Jones, "[Activist Investor Cevian Capital Raises Pressure on ThyssenKrupp](#)," *Financial Times*, 25 September 2013.

⁴² Simon Jessop, "[Knight Vinke Sees UBS Moving Towards Break Up](#)," *Reuters*, 18 June 2014.

⁴³ Inti Landauro, "[Fund Asks EADS to Sell Dassault Stake](#)," *Wall Street Journal*, 5 August 2013.

⁴⁴ Rodrigo Orihuela, Manuel Baigorri, Greg Farrell, and Jesse Drucker, "[A Stock Market Star Implodes in Spain](#)," *BloombergBusiness*, 17 July 2014.

Appendix 3: Participants

Members participating in all or parts of the meeting sit on the boards of about 40 large-, mid-, and small-capitalization public companies:

- Dr Werner Brandt, Audit Committee Chair, Lufthansa and RWE
- Mr Aldo Cardoso, Audit Committee Chair, GDF SUEZ
- Mr Ángel Durández, Audit Committee Chair, Mediaset España
- Dr Byron Grote, Audit Committee Chair, Unilever and Anglo American
- Ms Liz Hewitt, Audit Committee Chair, Novo Nordisk
- Mr Lou Hughes, Audit Committee Chair, ABB
- Ms Shonaid Jemmett-Page, Audit Committee Chair, GKN
- Dame DeAnne Julius, Audit Committee Chair, Roche Holdings
- Mr Chuck Noski, Audit Committee Chair, Microsoft*
- Mr Pierre Rodocanachi, Vice Chair and Audit Committee Member, Vivendi
- Ms Guylaine Saucier, Audit Committee Chair, Wendel

EY was represented in all or parts of the meeting by:

- Mr Jean-Yves Jégourel, EMEIA Assurance Leader
- Mr Christian Mouillon, Global Risk Management Leader
- Mr Steven Varley, UK Chairman and Managing Partner, UK and Ireland

*Member of the North American Audit Committee Leadership Network

Appendix 4: Questions for boards and audit committees

- ? What have your experiences with activists taught you about their objectives and strategies? What have you observed from activist interventions in competitor companies?
- ? What kind of preparations has your company made for activist intervention? Has your board considered an activist vulnerability assessment? Is the company attractive to activists because, for example, it is sitting on a large amount of cash? Do you see any red flags that make the company vulnerable?
- ? Does the board receive regular feedback on changes in the shareholder register? Does it receive regular reports containing feedback from long-term investors on company performance and the usefulness of its disclosures?
- ? Does management or the board regularly engage with major long-term investors?
- ? Has your company prepared an activist response plan and team?
- ? Do you know what activist-defense service providers you would use (e.g., investment banks, legal advisers, proxy solicitors, financial communication firms)?
- ? What factors will make you more likely to resist an activist campaign?