

THE ACTIVIST REPORT

13D Monitor

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10 Questions with James Langston



James E. Langston's practice at Cleary Gottlieb Steen & Hamilton LLP focuses on public and private merger and acquisition transactions, and friendly and hostile M&A, corporate governance, and contest-

ed situations. He has significant experience in both cross-border and domestic transactions, including conflict transactions, mergers-of-equals, LBOs, joint ventures, and carve-out transactions. Additionally, he frequently represents companies and their board of directors on takeover defense and shareholder activism situations. Jim joined Cleary in 2011 and became a partner in 2015. J.D., University of North Carolina School of Law (2005); B.A., University of North Carolina (2001). Jim is a member of Law360's 2020 M&A Editorial Advisory Board. He is also a member of the New York City Bar Committee on Mergers, Acquisitions, and Corporate Control Contests. He is also a member of the Society for Corporate Governance.

13DM: You have a notable background advising on M&A deals, please tell us more about your practice and in particular your work as it relates to shareholder activism, and the crossover that you see between shareholder activism and M&A.

JL: Activism – or the threat of activism – drives a meaningful portion of M&A

volumes. Activism was the catalyst for the de-conglomeritization of corporate America over the last 10-15 years as many companies engaged in carve-outs, spin-offs and broader portfolio reshaping to unlock their full sum-of-the-parts value. In the current environment, investors are valuing profitability over revenue growth and that has led to activists and companies alike re-examining corporate portfolios and shedding non-core, low-growth assets and investing in higher growth assets. Some companies will do that on their own, other companies will be forced to do it by activists. We are also seeing an uptick in unsolicited M&A as large-cap private equity funds and corporates with war chests look to act opportunistically as the recent stock market decline has made public company targets more attractive. The M&A market has been more resilient than the equity and debt markets in the current market dislocation and so this will be another source of activism at least for the near term.

13DM: Shareholder activism is a resilient strategy in that it adapts to different market environments. In the low interest rate environment of the past several years we have seen a lot of strategic activism. How do you see activism being affected in a high interest rate, inflationary environment?

JL: Recently, there have been an unprecedented number of shocks to the corporate landscape – persisting inflation, rise in interest rates, continued supply

chain disruption, the war in Ukraine, and more. This convergence of a more complex operating environment and stock market rout has created fertile ground for a surge in shareholder activism and that's exactly what we have seen in the first half of the year. The broader stock market decline has created buying opportunities that are more attractive for activists than at any point since the early days of the pandemic, and the increased pressure on profit margins gives activists an opening to agitate for a change in strategy. Today, many companies are more vulnerable than they have been at any other point in the cycle so preparedness is as important as ever.

13DM: Over the past 15 years shareholder activism has become more accepted among investors and commentators. As someone who advises boards and management, how have you seen the receptiveness to activists change in the C suite and the boardroom?

JL: Today, there are more activist-backed directors in corporate boardrooms than ever before. So like it or not, activists are part of the corporate landscape and that is not going to change anytime soon. In terms of companies' receptiveness to activists, I think it is situation specific. Most management teams and boards are guided by creating value and doing what's best for the company and its stakeholders. So if an activist has an idea that they think will create value or put the company on a better path, they are open to it and care less about who gets

Investor Communications Network
152 West 57th Street, 41st Floor
New York, NY 10019
www.13DMonitor.com
(212) 223-2282

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credit for the idea. But if they think the activist's ideas would destroy value or disrupt the progress the company is making then they are rightfully less receptive.

13DM: Since the successful Engine No.1/Exxon proxy fight, there has been a lot of discussion about the intersection of ESG and shareholder activism. How has that impacted your advice to clients? Do you think of proxy fights like Exxon as the beginning of a trend or a one-off?

JL: There has definitely been a convergence of ESG and activism. We are seeing traditional activists move beyond using ESG as a wedge issue and making it a central theme of their campaigns. At the same time, ESG activists are no longer relying solely on shareholder proposals as their weapon of choice but are increasingly borrowing from the activist playbook and running withhold campaigns targeting independent directors in the wake of ESG missteps or other corporate crises. This trend will undoubtedly continue, but we have not yet reached a point where ESG activism has overtaken traditional activism or represents the same threat to corporate strategy, and I think it is unlikely we will get there anytime soon.

13DM: We have recently seen the rise of a new activist defense technique where companies that are in the midst of a proxy fight issue convertible preferred stock on the condition, or with

the expectation, that the preferred stockholder will vote with the incumbent board. What are the pros and cons of adopting a defense like this?

JL: There have been a number of high-profile, white-squire investments coinciding with activist campaigns recently, but I don't view this as a corporate strategy designed to achieve a particular voting outcome. Companies pursuing this strategy should evaluate the cost of the new capital relative to other sources of capital available in the market, how the additional capital will be deployed and the operational or strategic expertise that the new investor will bring to the boardroom. On the right terms, the new investment conveys that the company is open to change and focused on doing what is best for shareholders. Oftentimes, the new investor enhances the boardroom diversity and opens the door to opportunities beyond what the activist could provide. Bottom line, the company must properly structure the investment to ensure it is in the best interests of shareholders and then articulate to the market why this is the optimal strategy for the company to pursue.

13DM: What effects do you think the advent of the universal proxy have on shareholder activism?

JL: There's no doubt the current U.S. proxy voting system is antiquated and in need of reform. But it would have been better for the SEC to have adopt-

ed rules to modernize the proxy voting system holistically rather than just moving on universal proxy. In terms of the rules themselves, it is a lowering of the drawbridge. To access the universal proxy card the activist can only needs to solicit 67% of the company's outstanding shares – which has become easier to achieve as ownership of most public companies is concentrated in fewer hands – and can use notice-and-access to do so. This will make it less expensive for activists to run a proxy contest, and while it may not result in a dramatic increase in the number of proxy contests in the near term, it will still make the threat of a successful proxy contest more credible and so enhance the activist's leverage in settlement discussions. It will also offer ESG activists an easier path to run a proxy contest and garner greater attention for ESG causes, but unless they are able to broaden their platform and attract high-quality director nominees ESG activists are unlikely to pose the same threat as traditional activists.

13DM: How do you see the SPAC market affecting activism and activists?

JL: The SPAC market is a small sliver of activism. The number of de-SPACed public companies is a small subset of the broader market, and the de-SPACed public companies tend to be smaller caps which makes up a smaller portion of overall activism. Most of the of the SPAC-focused activism campaigns have also been waged by activist short-sell-

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ers. They tend to take a short position in a company's stock, publish a white paper or other public critique of the company and profit as the stock price falls. Not surprisingly, de-SPACed public companies have been frequent targets of short activism amidst the dramatic decline in SPAC stock indexes and broader rotation out of pre-revenue / growth equity investments and focus on profitability. In the near term, SPAC-focused short activism will likely continue along with the broader shake out in the SPAC market, but I don't think that SPAC-focused activism will drive long activism or reshape the broader activism market.

13DM: The SEC has proposed several new rule amendments, including a.) reducing the time investors have to file a 13D from 10 days to five, b.) shortening the time investors have to file Schedule 13D amendments to one business day; and c.) redefining the definition of beneficial ownership to include certain derivatives, such as cash settled swaps. What is your view of these proposals?

JL: The 13D modernization reforms were long overdue and a step in the right direction. Greater transparency to the market should be welcomed by companies and investors alike. Today,

public companies disclose more information to investors than ever before. Holding large investors to the same standard is only fair. The 13D reforms are not going to stop activism, but they do rebalance the playing field. Activists will likely adapt their trading strategies to navigate the new rules and preserve the profitability of the asset class.

13DM: There have been a lot of majority control proxy contests this season. Is this something you expect to see more of or is it just an anomaly?

JL: There's a high bar to activists prevailing in a change-of-control slate proxy contest. It is harder to get ISS / GL support and harder to convince institutional investors. There has to be a clear failure at the company and the activist has to articulate a strategy of how they plan to run the company for the long-term and deliver superior value, and not just make changes around the edges. That's a tall task. Activists also realize that they do not have to gain a control of majority of the boardroom to have significant influence and bring about change. So we will continue to see activists launch change-of-control proxy contests as a pressure tactic that are reduced to minority slates, but we do not expect to see change-of-control

proxy contests become the norm.

13DM: What does shareholder activism look like ten years from now? How do you expect it to evolve?

JL: I have been doing this long enough to know not to make predictions. But it feels like the complex macroeconomic and operating environment we are in today is going to persist for longer than we'd like. That's likely to unleash a wave of activism that will be with us for years to come. At the same time, as large-cap activists continue their evolution we expect more of them to morph into private equity funds, just as many private equity shift their focus to becoming broad-based asset managers with an activism-like investment strategy as one of many asset classes under their umbrella. I also expect ESG-investment funds to face greater regulatory scrutiny and for ESG activists to become even more aggressive than they are today. Finally, as consolidation among asset managers and capital allocators continues and conglomeritization re-appears in the form of index funds and private market owners, it will be interesting to see whether activists turn their sights to these institutions.

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