



HLS PROGRAM ON CORPORATE GOVERNANCE & PROGRAM ON INSTITUTIONAL INVESTORS

CORPORATE GOVERNANCE VIRTUAL ROUNDTABLE SERIES

March 11, 2021 Session

The 2021 Proxy Season: Shareholder Engagement

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The 2021 Proxy Season: Shareholder Engagement

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Our Approach to Sustainability

Posted by Sandra Boss, BlackRock, Inc., on Monday, July 20, 2020

Editor's note: Sandra Boss is Global Head of Investment Stewardship at BlackRock, Inc. This post is based on a BlackRock report authored by Ms. Boss, Michelle Edkins, Amra Balic, Gassia Fox, Jon Posen, and Jim Badenhausen. Related research from the Program on Corporate Governance includes [The Illusory Promise of Stakeholder Governance](#) by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum [here](#)) and [Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee](#) by Robert H. Sitkoff (discussed on the Forum [here](#)).

This past January, BlackRock wrote to clients about how we are making sustainability central to the way we invest, manage risk, and execute our stewardship responsibilities. This commitment is based on our conviction that climate risk is investment risk and that sustainability-integrated portfolios, and climate-integrated portfolios in particular, can produce better long-term, risk-adjusted returns.

Our efforts around sustainability, as with all our investment stewardship activities, seek to promote governance practices that help create long-term shareholder value for our clients, the vast majority of whom are investing for long-term goals such as retirement. This reflects our approach to sustainability across BlackRock's investment processes, in which we use Environmental, Social, and Governance factors in order to provide clients with better risk-adjusted returns, in keeping with both our fiduciary duty and the range of regulatory requirements around the world. As a result, we have a responsibility to our clients to make sure companies are adequately managing and disclosing sustainability-related risks, and to hold them accountable if they are not.

While we have been speaking with companies for years on sustainability issues, our investment stewardship team has intensified its focus and dialogue this year with companies facing material sustainability-related risks. Our approach on climate issues, in particular, is to focus our efforts on sectors and companies where climate change poses the greatest material risk to our clients' investments. 'Climate risk' may include a company's ability to compete in a world that has transitioned to a low-carbon economy (transition risk), for example, or the way climate change could impact its physical assets or the areas where it operates (physical climate risk).

As with other matters of corporate governance, we use the two key instruments of the stewardship toolkit: engagement and voting.

Engagement is how we build our understanding of a company's approach to governance and sustainable business practices, and how we communicate our views and ensure companies understand our expectations.

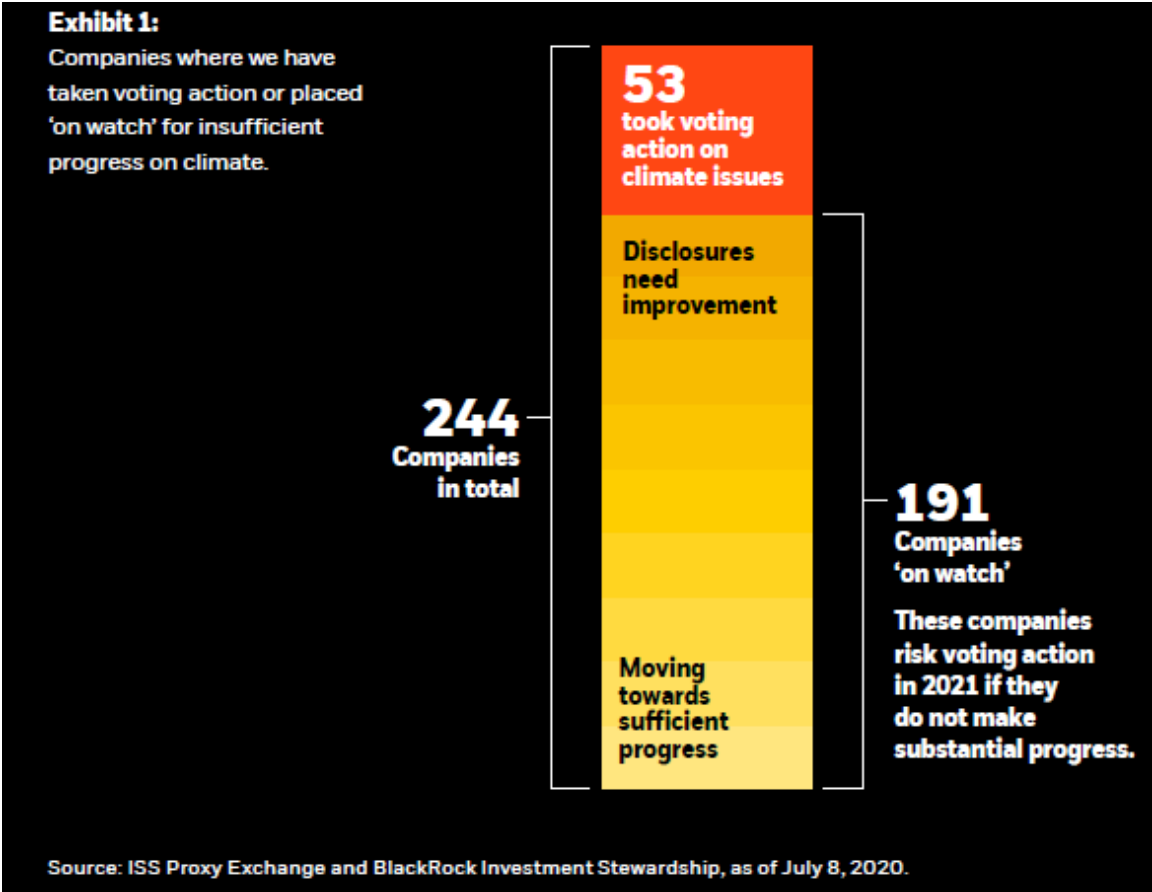
Voting is how we hold companies accountable when they fall short of our expectations. Our voting actions typically take the form of either votes against company directors (or boards) or support for shareholder proposals (SHP).

Our approach on climate issues, in particular, is to focus our efforts on sectors and companies where climate change poses the greatest material risk to our clients' investments.

In order to maximize our impact on behalf of clients, our climate-related engagements are focused on companies in carbon-intensive sectors that, taken together, represent a significant proportion of market capitalization and CO2 emissions in their respective regions.

These companies face material financial risks in the transition to a low-carbon economy that we need to understand as long-term investors.

In 2020, we identified 244 companies that are making insufficient progress integrating climate risk into their business models or disclosures. Of these companies, we took voting action against 53, or 22%. We have put the remaining 191 companies 'on watch.' Those that do not make significant progress risk voting action against management in 2021.



We have engaged hundreds of other companies on climate and sustainability-related issues over the years. Many companies have made important progress in recent years, and we will continue to engage with them to monitor this progress. We have also identified a number of companies outside the carbon-intensive sectors that present high sustainability-related risk for heightened engagement over the next year.

While this report focuses on climate-related issues, our investment stewardship approach to sustainability is much broader. It encompasses other environmental issues, such as sustainable practices in **agribusiness**. Our stewardship also includes topics that have been central to many companies' license to operate, particularly over the past few months, such as **human capital management and diversity and inclusion**. The COVID-19 crisis, and more recently the protests surrounding racial injustice in the United States and elsewhere, have underscored the importance of these issues and a company's commitment to serving all of its stakeholders.

In January, we asked companies to publish disclosure aligned with the Sustainability Accounting Standards Board (SASB) standards, which includes disclosing the racial and ethnic profile of their U.S. workforce. In the second half of 2020, as we assess the impact of companies' response to COVID-19 and associated issues of racial equality, we will be refreshing our expectations for human capital management and how companies pursue sustainable business practices that support their license to operate more broadly. We also will continue to emphasize the importance of diversity in the board room and will consider race, ethnicity, and gender as we review a company's directors.

The COVID-19 crisis, and more recently the protests surrounding racial injustice in the United States and elsewhere, have underscored the importance of these issues and a company's commitment to serving all of its stakeholders.

Through this report, we hope to provide a deeper look at our engagement process and methods; how we are working to promote transparency in investment stewardship, both in our own activities and through the adoption of disclosure standards ¹; our involvement with Climate Action 100+; and our view on the importance of social factors to the long-term health of companies and society as a whole.

Going forward, we will continue to review our process for engaging and voting on climate risk and other sustainability-related issues. We have made important progress heightening our focus on sustainability, but we are also committed to constantly enhancing our approach in order to protect our clients' long-term investments.

¹ We asked in **January 2020** that companies publish reports aligned with the recommendations of the Task-Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB) standards.

Our approach on climate engagement

■ We began this process with a series of letters in 2017 and 2018.

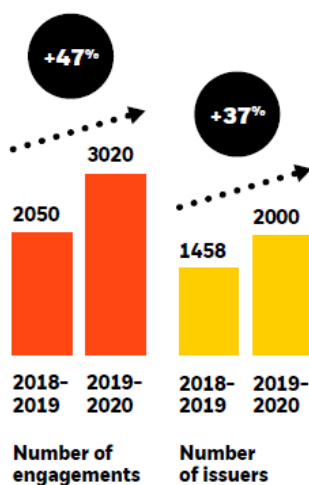
We have been engaging for several years with companies—particularly those in carbon-intensive industries—regarding the need to enhance disclosure of climate risks and how they will impact business models over time.

We began this process with a series of letters in 2017 and 2018, prioritizing companies with the most carbon-intensive business models where BlackRock’s clients collectively were significant shareholders.

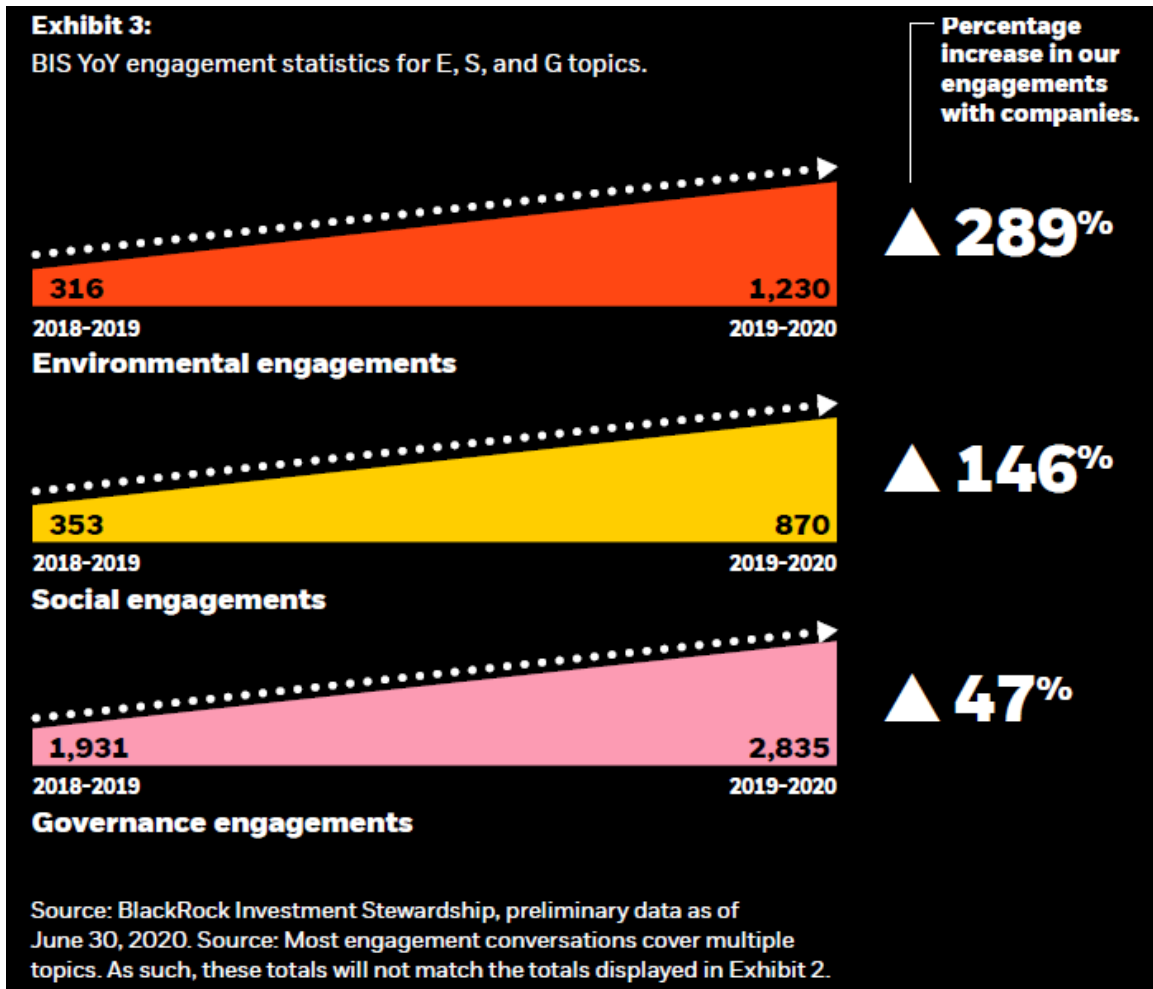
Our objective was to bring the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) to the attention of company leadership and ask them to consider reporting in line with the TCFD framework. This past **January**, we elevated our request, explicitly asking companies to report in line with TCFD standards.

In our direct dialogue with company leadership, we seek to understand how a company’s strategy, operations and long-term performance would be affected by the transition to a low-carbon economy and other climate risks. Broadly, we aim to ensure that companies are effectively managing the risks and opportunities presented by climate change and that their strategies and operations are aligned with the transition to a low-carbon economy—and specifically, the Paris Agreement’s scenario of limiting warming to two degrees Celsius or less, which is laid out in the ‘Metrics and Targets’ pillar of the TCFD framework. Such engagement can help inform the approach taken by corporate leadership as they advance their sustainability practices and disclosure.

Exhibit 2:
BIS YoY total engagements
and issuers engaged.



Source: BlackRock Investment Stewardship, preliminary data as of June 30, 2020.



Our approach employs a natural escalation process. If we are not satisfied with a company's disclosures, we typically put it 'on watch' and give the company 12 to 18 months to meet our expectations. (The complexity of many sustainability issues may necessitate detailed reviews of operations by the company if it is to make substantive disclosures that inform investors.) If a company has still failed to make progress after this timeframe, voting action against management typically follows.

In our engagements, we often see examples of companies whose disclosures, targets, and business practices on climate issues align with our expectations. We have identified over 60 who fit this category. For these companies, we will continue to engage to ensure that their long-term capital investments and business decisions continue to align with the commitments they have made.

Voting actions

There are two main categories of our voting actions: holding directors accountable and supporting shareholder proposals.

When we vote against a company, we do so with a singular purpose: maximizing long-term value for shareholders. There are two main categories of our voting actions: holding directors accountable and supporting shareholder proposals. Both can be valuable tools in the stewardship toolkit. Shareholder proposals, while often non-binding and less common outside of the U.S., can garner significant attention and send a strong public signal of disapproval. Our approach typically employs votes against directors more frequently since they are a globally applicable signal of concern; additionally, significant votes against directors register strongly with both the individual director and the full board, and, importantly, failure to win a substantial majority frequently results in a director stepping down before the next annual meeting.

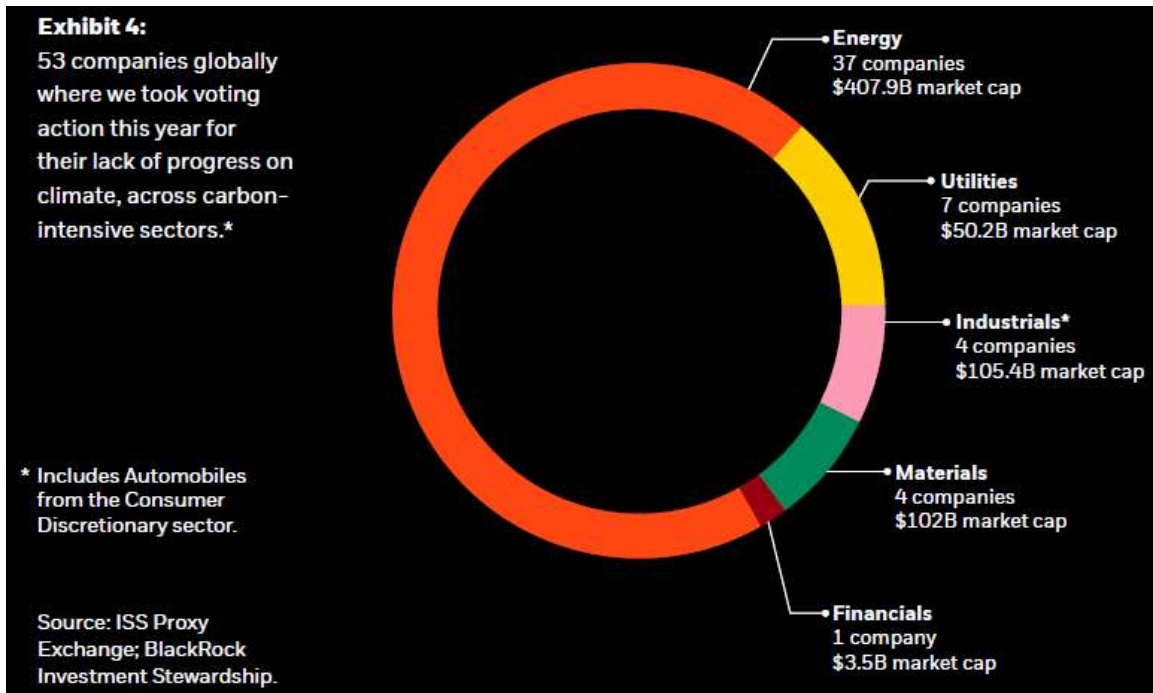
We usually express our concern about lack of effective governance of an issue by voting against the re-election of those directors with oversight responsibility for the issue of concern or those in senior leadership roles on the board.

In certain European markets, concerns about a board's performance may be reflected by a vote against the approval (or 'discharge') of a board's actions over a year. Electing directors is a fundamental shareholder right in the vast majority of the markets in which BlackRock invests on behalf of our clients, with elections held annually at most companies. As such, it is an effective, globally applicable tool to hold companies accountable for poor governance practices in general, and for lack of progress on sustainability issues more specifically.

Voting on shareholder proposals offers another way to express targeted disapproval of a company's policies or practices. BIS may support shareholder proposals that address issues material to a company's business model, which need to be remedied urgently and that, once remedied, would help build long-term value. We may support proposals seeking enhanced disclosure if the information requested would be useful to us as an investor and if management has not already substantively provided it. To gain our support, the requests made in a shareholder proposal should be reasonable and achievable in the time frame specified. In some cases, shareholder proposals address issues that may not be material to the company's business operations or risk or suggest changes that are not reasonably achievable within the specified timeframe. In such instances, we generally decline to support the proposals but may vote against directors where we agree that the proposal highlights a failure (such as insufficient climate risk disclosure).

During the 2020 proxy season, we took voting action against 53 companies for their failure to make sufficient progress regarding climate risk disclosure or management. Voting action means that we voted against the re-election of one or more members of a company's board, voted against the discharge of directors or the entire board in certain European markets, or voted for one or more climate-related shareholder proposals.

A wide variety of investors, including BlackRock, have expressed their concerns about the investment risks of insufficient climate risk management. In 2020, we took voting action against those companies where we found corporate leadership unresponsive to investors' concerns about climate risk or assessed their disclosures to be insufficient given the importance to investors of detailed information on climate risk and the transition to a low-carbon economy. In the appendix, in Exhibit 5, is a list of companies that we held accountable through voting for a lack of progress on climate risk disclosures.



Placing companies 'on watch'

Of the 244 companies we identified as not making sufficient progress in 2020, we have placed 191 companies 'on watch' regarding climate disclosure. While these companies' disclosures are insufficient based on our assessment today, and as such raise concerns about long-term value creation, we did not take voting action this year. We expect each of these companies to make substantial progress prior to the 2021 annual meeting or risk our voting action against boards and management in 2021.

In some cases, these companies had legitimate concerns that delayed their progress on climate issues in 2020, such as responding to the economic crisis and existential threat to business models sparked by the COVID-19 pandemic. In other cases, disclosure standards are evolving for certain sectors, for example, there are several concurrent projects between financial services companies and key institutions, such as the United Nations, that will enhance future reporting. These projects aim to develop reporting methodologies on scenario analysis, stress tests, and science-based Scope 3 emissions definitions and measurement for companies. As a result, we expect companies outside carbon-intensive sectors to be better positioned to provide more complete TCFD-aligned reporting in the near future.

In our assessment, many of these companies are making progress to provide sufficient disclosures by year-end 2020. However, other companies have yet to fully acknowledge the risks and opportunities posed by the transition to a low-carbon economy.

244

Companies we identified as not making sufficient progress in 2020.

191

Companies we have put 'on watch'.

Initiating engagement

We have identified 110 other companies across carbon-intensive sectors to initiate engagement with in the second half of 2020. These 110 companies represent over \$2.7 trillion in market cap of carbon-intensive industries, nearly 1.7 billion tons of CO2 emissions (Scope 1 and 2) and over \$132 billion of our clients' exposure.

These are companies where we have had limited or no climate-related conversations to date but have potentially engaged on a number of other governance-related topics. These companies generally fall into two categories. The first category is companies based in emerging market countries that are heavily reliant on carbon-intensive sources of energy such as coal, and as a result, at an earlier stage of addressing climate change. The second category is companies in sectors that are in the next wave in tackling climate change, such as financial services, whose emissions generally are what is considered Scope 3. While we have already had conversations with a number of banks, we plan to increase these engagements over the next year as the sector improves its understanding of Scope 3 disclosures.

Promoting transparency on climate and broader sustainability risks

We believe that all investors need a clearer picture of how companies are managing sustainability-related risks and opportunities.

BIS has long been committed to initiatives that inform and influence governance and reporting practices at the market level, which helps benefit not only our clients but all investors. In relation to climate risk, we have advocated for companies to report in line with the TCFD and SASB frameworks.

We have engaged companies on grounds similar to the strategy of Climate Action 100+, which we joined in January of this year. BIS also enhanced its own disclosures of its stewardship activities to help clients, companies and other stakeholders to better understand our engagement, voting, and advocacy.

Engaging on TCFD and SASB to drive adoption

We believe that all investors need a clearer picture of how companies are managing sustainability-related risks and opportunities.

We advocate for companies to use the **TCFD framework and SASB standards** as the basis for their sustainability reporting. Both are practitioner-led and continue to evolve in response to feedback from stakeholders on the materiality of certain sustainability issues, on what information is most relevant to investment decision-making and on the need for globally applicable, industry-specific reporting standards. BlackRock contributes to improving market practices, as an original member of the TCFD Board and a member of the Investor Advisory Group of the SASB. We also expect that emerging regulatory standards, particularly the European Union's Non-Financial Reporting Directive, will provide the granular, comparable metrics and targets that investors are seeking.

TCFD and climate engagement in developing market countries

Developing countries and their companies are at very different stages in terms of climate risk management and disclosures relevant to investors. For much of the developing world, sustainability-related disclosure norms are nascent and there is considerable opportunity in the coming years for reporting and target-setting to improve, supported by policy developments and investor engagement.

In our view, the TCFD framework is a valuable tool for enhancing how companies in developing markets can manage and disclose information pertaining to material risks and opportunities from climate change. In the first half of this year, we wrote letters to the CEOs of companies representing 90% of the Asia ex-Japan market to bring our expectations for TCFD-aligned disclosures to their personal attention.

Climate Action 100+

BlackRock joined Climate Action 100+ (CA 100+) in January of this year, a natural progression in our work to advance corporate reporting aligned with TCFD. CA 100+ is a group of investors that engages with companies to improve climate disclosure and align business strategy with the goals of the Paris Agreement.

Prior to joining, BlackRock was a member of the group's five partner organizations². BIS's climate engagement universe includes nearly all of the companies in the CA 100+ list (except those whose ownership structure means we doubt our engagement would influence corporate behaviors). Beyond the CA 100+, BIS's climate engagement universe also includes over 200 additional companies that we believe warrant prioritization. CA 100+ members benefit from the

² Asia Investor Group on Climate Change (AIGCC); Ceres; Investor Group on Climate Change (IGCC); Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI).

group's collective insights, but each investor determines how to vote their holdings independently of other members ³.

As a member of CA 100+'s Asia Advisory Group, and the Asia-region sponsoring organizations, we seek to provide the group with strategic insight into the characteristics of local Asian markets to help inform engagements. Together with Cathay Financial, we have taken on the role of lead investor in engagement with China Steel, a Taiwanese company. In this engagement, we are encouraging China Steel to enhance its climate disclosures and to pursue more ambitious targets and investment plans to transition its business in line with a lower than 2-degree Celsius scenario.

Sustainability issues beyond climate

■ We have long made human capital management one of our engagement priorities.

Since the beginning of the COVID-19 pandemic, we have engaged with more than 380 companies across all 11 GICS sectors and 29 countries globally to understand how they are balancing short-term pressures created by the COVID-19 crisis with efforts to oversee long-term material financial and operational performance.

In particular, we have focused on how the crisis has impacted companies' commitment to sustainable social practices—that is, the compensation, employee development and advancement, working conditions for employees and suppliers, local community outreach, and other measures companies put in place to build a diverse, engaged workforce and a strong corporate culture within supportive local communities.

It is our investment conviction, grounded in research ⁴, that companies with sustainable business practices can deliver better long-term, risk-adjusted returns. Companies with clear purpose that build strong relationships with their employees, suppliers, and other stakeholders are more likely to meet their strategic objectives, while poor relationships can reduce productivity, harm product and service quality, and even jeopardize a company's social license to operate.

For this reason, we have long made human capital management one of our engagement priorities. Our broad **approach to human capital management** touches upon eight of the UN's Sustainable Development Goals—including decent work and economic growth, gender equality, reduced inequalities, and good health and well-being. Well-supported employees, who align with the company's purpose, are more likely to be engaged and play a central role in creating sustainable long-term value. As such, our approach focuses on the board's effectiveness in overseeing how a company meets the expectations of its workforce.

■ In our recent engagements, we have found many companies that are finding ways to strengthen their commitment to employees and other stakeholders during the pandemic, from establishing employee relief funds to providing meals to local hospitals.

³ As the CA 100+ website notes: "All investor signatories to the Climate Action 100+ initiative are responsible for their own voting decisions—this includes pre-declaration and vote Climate Action 100+ investor networks do not seek to provide voting recommendations or to facilitate block voting."

⁴ BlackRock Investment Institute: **Sustainable Investing: a 'why not' moment; Sustainability: the bond that endures.**

Because COVID-19 poses an existential threat for many companies, it is also straining the social contract between companies and their employees and other stakeholders. As companies reduce staffing levels and restart post-lockdown, for many workers, the promise of decent work in safe conditions feels increasingly remote. In some countries, the resultant economic dislocation has heightened economic, gender and racial inequality. As long-term investors, we believe that companies forced into difficult choices affecting employees, suppliers and local communities—especially those companies receiving government financial support—need to make prudent, balanced decisions about executive and board compensation and allocation of capital.

Where we are unconvinced that companies are preserving their social license to operate—whether in the context of the pandemic or more broadly—we may take voting action.

For example:

- We voted against management at Tyson Foods, a S. packaged food company, by supporting a shareholder proposal on supply chain due diligence because we were not satisfied with the company’s disclosures and practices around sustainable working conditions.
- We voted against the re-election of a director at McKesson, a U.S. pharmaceutical company, for the company’s failure to take adequate remedial action for their role in the U.S. opioid crisis.
- We supported a shareholder proposal at financial services company Santander Consumer USA where we were concerned that the risks of racial discrimination in lending practices were not being managed in a transparent and effective manner.
- We supported a shareholder proposal at S. technology company Fortinet that demanded greater disclosure around the company’s diversity and inclusion efforts.
- And we voted against management at Ocado, a UK online grocery retailer, over concerns that the board did not exercise appropriate oversight of executive compensation given the current economic environment, potentially harming its relationship with consumers.

We believe issues that could threaten a company’s license to operate will become even more acute in the wake of the COVID-19 crisis.

We have also engaged extensively over the year on **purpose and culture**, which both reflect whether a company exhibits a stakeholder-focused orientation. In our recent engagements, many companies have described to us the importance as they responded to COVID-19 of the prior work they have done to align their mission, vision, and values with their day-to-day operations.

The consistent message we have heard is that a strong, purpose-driven culture provides companies with a unifying concept for employees and external stakeholders on which they depend.

* * *

The complete report is available [here](#).

Shareholder Engagement Trends and Considerations

Cleary Gottlieb, January 11, 2021

In 2020, the COVID-19 pandemic, economic uncertainty, divisive politics and a historic social justice movement presented unprecedented challenges for boards. While the pandemic eliminated the concept of an in-person boardroom, as well as investor site visits, one-on-one meetings at conferences and strategy retreats, work did not slow, and most directors reported devoting significantly more time to their duties.¹

Boards stepped up to the challenge during the crisis, showing heightened awareness of and focus on environmental, social and governance (ESG) issues highlighted by the COVID-19 pandemic, such as company culture, human capital management, long-term strategy and executive compensation.

In 2021, maintaining and building shareholder relationships through effective engagement will be more important than ever as boards reflect on 2020 and plan for the future. Shareholders will likely be pushing companies to address strategy adjustments, changes in capital allocation and executive compensation in advance of the 2021 proxy season.²

Below, we discuss what is motivating shareholders and considerations for companies and their board members in crafting and executing an effective strategy for communicating with investors and other constituents, during proxy season and the off-season.

Background

Shareholder engagement continues to be an important consideration for companies in communicating long-term strategy and deepening relationships with investors. Investors have increased their focus on shareholder engagement in recent years, and large institutional shareholders have made it a priority by expanding their stewardship teams and increasing the number of engagements every year. In the past, shareholder engagement usually involved meetings with company management or the investor relations team, but board members have become increasingly involved in the process.

According to a recent survey, 94% of institutional investors stated they must trust a company's board before making or recommending an investment.³ In PwC's 2020 Annual Corporate Directors Survey, 58% of the directors reported that a member of their board, apart from the CEO, engaged directly with a shareholder in the past year, up from 51% in 2019 and 42% in 2017.⁴ This development is partly due to investors' heightened focus on ESG and any deviations in strategy, as well as their view that directors are well-positioned to discuss company goals.⁵

¹ PwC 2020 Annual Corporate Directors Survey (2020).

² PwC 2020 Annual Corporate Directors Survey (2020).

³ Edelman Trust Barometer Special Report: Institutional Investors (2020)

⁴ PwC 2020 Annual Corporate Directors Survey (2020).

⁵ PwC Director-Shareholder Engagement: Getting it Right (2020).

Both investors and boards share positive feedback on their engagement. According to the Morrow Sodali 2020 Institutional Investor Survey, 91% of institutional investors surveyed stated that engagement at the board level is the most effective way for investors to influence board policies and engagement. From the boards' perspective, 91% of directors thought investors were well-prepared for the engagement, and 87% of directors believe that engagement has or is likely to have a positive impact on proxy voting, substantially up from 59% in 2016.⁶

Off-Season: Shareholder Engagement

While a big part of shareholder engagement in the first half of 2020 was driven by the impact of COVID-19 on company operations and performance, large institutional investors continue to focus on strategic matters and remain committed to ESG issues, as part of their off-season engagement.

BlackRock's Investment Stewardship team had more than 400 engagements in which they discussed the impact of COVID-19 in the first half of 2020 and noted they were able to be supportive as companies sought flexibility from investors in the early days of the COVID-19 pandemic. In its 2020 Investment Stewardship Annual Report, BlackRock noted that "given the unprecedented circumstances, we aimed to be constructive and support companies on proposals outside our normal governance policies, such as virtual shareholder meetings, supporting poison pills, dividend cuts, off-cycle revision of executive pay, and authorization for additional financing without shareholder approval."⁷ Concurrently, BlackRock emphasized the importance of corporate leaders seeking a "long-term strategic response to the crisis that is more responsive to the expectations of all their stakeholders."⁸

BlackRock's Investment Stewardship team engaged with more than 1,000 companies in 2020 on corporate strategy, an increase of nearly 50% over the prior year, and noted that companies are responding to an acceleration of strategic trends in digitalization and evolution in global supply chains with a reallocation of capital toward more sustainable business practices. Moreover, they expected companies to stay committed to societal impact and ESG issues. In 2020, the BlackRock team engaged with over 640 companies on human capital management issues and another 125 on other social issues.⁹ Vanguard similarly emphasized the board's responsibility in overseeing a company's long-term strategy and material risks, with a particular focus on climate change and diversity issues.¹⁰ For additional details on these sustainability topics, see Corporate Sustainability: Moving Faster and Faster to the Center of Strategy and Shareholder Value and Emphasis on Diversity Initiatives Broadens in Scope and Focuses on Impact in this memo.

In 2020, investors placed high expectations on company disclosure, especially in light of the COVID-19 pandemic and various corporate measures that were taken in response. BlackRock noted, "companies will have to justify these difficult choices in their 2020 reporting and explain how they weighed their decisions in relation to balancing the interests of investors, employees, customers, suppliers, and communities."¹¹ Shareholders are not only requesting additional

⁶ PwC 2020 Annual Corporate Directors Survey (2020).

⁷ BlackRock 2020 Investment Stewardship Annual Report (2020).

⁸ BlackRock 2020 Investment Stewardship Annual Report (2020).

⁹ BlackRock 2020 Investment Stewardship Annual Report (2020).

¹⁰ Vanguard 2020 Investment Stewardship Annual Report (2020).

¹¹ BlackRock 2020 Investment Stewardship Annual Report (2020).

information but also are focusing on the quality of disclosure, in particular with respect to topics such as climate change, human capital management, board involvement in establishing the culture at the company and health and safety indicators.¹²

According to the 2020 Morrow Sodali survey, investors recommend Sustainability Accounting Standards Board (SASB) (81%) and Task Force on Climate-related Financial Disclosures (TCFD) (77%) as best standards to communicate ESG information. Notably, both BlackRock and Vanguard encouraged companies to publish reports aligned with the recommendations of TCFD and the SASB standards. Further, 91% of investors expect companies to demonstrate a link between financial risks, opportunities and outcomes with climate-related disclosures.¹³ BlackRock noted in its 2020 annual letter that it will be increasingly disposed to vote against management and board directors “when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them.”¹⁴ State Street similarly noted that it “will take appropriate voting action against board members at companies in the S&P 500, FTSE 350, ASX 100, TOPIX 100, DAX 30, and CAC 40 indices that are laggards based on their R-Factor scores and that cannot articulate how they plan to improve their score.”¹⁵

As investors’ expectations for enhanced disclosure rise, companies and boards should consider proactively disclosing information of shareholder interest and be prepared to communicate ESG information through relevant metrics.

Considerations for 2021

In preparation for the 2021 proxy season and engagement with shareholders, boards and management should consider the following in developing a strategy for engaging with shareholders and communicating with other stakeholders.

Strategize on Long-Term Plan and Crisis Management

- Be informed and aligned in developing the company’s long-term strategic vision. The board should rearticulate the long-term plan for the company based on the lessons learned from the COVID-19 pandemic.
- Ensure there is consistent messaging among all constituencies (e.g., investors, employees, customers and suppliers). A unified and consistent message with robust shareholder communication builds support for the company’s long-term plan, as well as any corporate measures and responses to be taken in response to the pandemic.
- Be specific and aligned in identifying a corporate purpose and culture and demonstrating how it informs the company’s plans for growth, financial performance and crisis management.
- Be ready to discuss how key ESG and sustainability topics that are particularly salient to the company and the industry relate to the company’s long-term plan.

¹² Morrow Sodali Institutional Investor Survey (2020).

¹³ Morrow Sodali Institutional Investor Survey (2020).

¹⁴ BlackRock 2020 Annual Letter to CEO (2020).

¹⁵ State Street 2020 Annual Letter to Board Member (January 28, 2020).

Know Your Investors

- Identify and pay particular attention to the company's largest shareholders and key stakeholders for regular outreach.
- Review investors' stock holdings, published guidelines, policies, statements, voting history and involvement in campaigns for shareholder proposals, governance initiatives or activism, including any recent adjustments driven by the pandemic.
- Maintain an open mind. Directors often think of a shareholder proposal as a line of attack or an escalation tactic, but some investors think of it as a strategic approach to engagement. Once an investor opens the line of communication with the company, it may be willing to discuss the issue and come to a resolution that results in a withdrawal of the proposal.¹⁶

Review and Revise Disclosure

- Include voluntary disclosure regarding current engagement with shareholders, feedback received from shareholders and how the company responded. Many companies are providing this information in their proxy statements in the summary, corporate governance and executive compensation sections. Some companies describe the number of shareholders with which they met, whether directors participated in the engagement, topics discussed and any changes that the company is implementing or considering implementing as a result.
- Consider making the connection between shareholder engagement and board member skills. Some companies are not only describing how and why the board participates in shareholder engagement but also leveraging disclosure about directors' skills to highlight what the directors bring to the discussion.¹⁷ When proxy materials state that directors are discussing certain topics with shareholders, it is helpful for investors to see what makes those particular directors qualified on those topics.
- Provide more granular ESG-related and other disclosure specific to the company, its business and its risks.
- Take investor concerns into consideration when creating and updating public information, including disclosure, presentations, websites, sustainability reports, CSR reports and other publicity vehicles, including social media.
- Ensure that the board, management and other members of the company coordinate to maintain current and consistent disclosure and communication with investors and other stakeholders.

Focus on Key Topics

- Consider adding disclosure and reporting on key concerns for investors such as climate change and human capital management, consistent with frameworks and standards recommended by investors, such as the TCFD and SASB.
- Highlight steps the company is taking to ensure value creation is not impeded by adverse impacts arising from neglect of ESG issues.

¹⁶ PwC Director-Shareholder Engagement: Getting it Right (2020).

¹⁷ PwC Director-Shareholder Engagement: Getting it Right (2020).

- Consider linking executive compensation practices to strategy and performance, including financial, operational and sustainability measures.¹⁸
- Address topics about which there are misunderstandings or controversies (whether raised by analysts, media or activists, or conveyed privately to the company).
- Benchmark governance and other practices against similarly situated issuers, including competitors, others in the sector or index and others in a specific investor's portfolio.

Other Process Considerations for Engagement

- Determine who will be best-positioned to engage directly with investors on a particular topic or issue:
- Management participants usually include the CEO, CFO and an IR officer and may include business development or sustainability teams and, in some cases, the heads of specific business units of interest.
- Many large institutional investors, especially top shareholders, increasingly expect to be able to directly engage with directors, in particular on questions regarding strategy.
- Directors should be trained on how to most effectively engage on these issues.
- Take into account restrictions around quiet periods ahead of earnings releases, typically right after the quarter ends.
- Be vigilant about avoiding disclosure of material nonpublic information that would violate Regulation FD.
- Set a consistent procedure and internal standards on whether to hold audio-only or video meetings as engagement has been and will be virtual for some time.

Proxy Season: Virtual Annual Meetings in the Era of COVID-19

Given various government restrictions on travel, stay-at-home orders and social distancing measures that prohibited gatherings of more than a certain number of individuals, public companies needed to think creatively and quickly about how to approach the traditional proxy season and to hold annual meetings from April through June. Most companies shifted from a proxy season of traditional in-person annual meetings to virtual shareholder meetings. Broadridge Financial Solutions, Inc., one of the most widely used vendors for a virtual meeting platform, reported that it hosted 1,494 virtual shareholder meetings during the first six months of 2020.¹⁹

Looking ahead to the 2021 proxy season, companies can draw on the lessons from 2020 and analyze a few key considerations as they plan for whether and how to hold virtual shareholder meetings.

¹⁸ For additional details on the use of ESG metrics in incentive compensation, please see ESG Considerations for Incentive Compensation Programs in this memo.

¹⁹ Broadridge, "Virtual Shareholder Meetings 2020 Mid-Year Facts and Figures" (2020).

Considerations for 2021

Consider State Corporate Law

- A company considering a virtual shareholder meeting should take into account the laws of the state in which it is incorporated. The majority of states, including Delaware, allow companies to hold virtual-only annual shareholder meetings. Many states that generally require an in-person meeting or a “hybrid meeting” with an in-person component provided relief in 2020 through executive orders or amendments to the governing statutes.
- Originally, the New York Business Corporation Law (NYBCL) did not expressly authorize virtual-only shareholder meetings. New York Governor Andrew Cuomo issued an executive order in March 2020 that temporarily suspended certain subsections of the NYBCL that require meetings of shareholders to be held at a physical location. In June 2020, Governor Cuomo enacted temporary amendments to the NYBCL that codified such relief.²⁰ Section 602(a) of the NYBCL was temporarily amended to give boards of directors the discretion to convene a virtual-only shareholder meeting.²¹ The amendments will remain effective for the duration of the state of emergency, subject to an outside expiration date of December 31, 2021. For New York corporations, boards will have an option of determining whether to hold virtual-only shareholder meetings so long as the state of emergency remains in place.
- The California Corporations Code permits corporations to hold virtual meetings provided that all stockholders consent to the format, a requirement with which it is practically impossible for public companies to comply. California Governor Gavin Newsom in March 2020 issued an executive order that temporarily suspended this shareholder consent requirement for virtual meetings for the duration of the state of emergency.²²
- The status of this type of relief for 2021 annual meetings remains uncertain, given all the uncertainties around when pandemic related restrictions will wind down. Companies incorporated in states like New York and California will have to prepare for the possibility that a virtual-only meeting may be permitted when the company files its proxy statement but may no longer be permitted by the date of the annual meeting. Conversely, while restrictions on gatherings may be relatively loose when a proxy is filed, increases in COVID-19 cases could lead to restrictions and lockdowns at the time of the annual meeting. Companies should closely monitor developments in their state of incorporation and review their corporate governance documents to utilize any form of emergency relief provided from state restrictions on virtual-only shareholder meetings.

²⁰ Senate Bill 8412.

²¹ Paragraph (a) of Section 602 of the NYBCL, in its amended form, states: “Meetings of shareholders may be held at such place, within or without this state, as may be fixed by or under the by-laws, or if not so fixed, as determined by the board of directors. For the duration of the state disaster emergency declared by executive order two hundred two that began on March seventh, two thousand twenty, if, pursuant to this paragraph or the by-laws of the corporation, the board of directors is authorized to determine the place of a meeting of shareholders, the board of directors may, in its sole discretion, determine that the meeting be held solely by means of electronic communication, the platform/service of which shall be the place of the meeting for purpose of this article.”

²²Executive Order N-40-20 (March 30, 2020).

Consider Investor Feedback and Consult Virtual Meeting Service Providers

- In planning for 2021, companies should engage with their shareholders during the off-season to solicit feedback on the virtual shareholder meeting process from 2020 and consider implementing changes to address that feedback if necessary.
- Many investors shared positive feedback that they were able to attend annual meetings without traveling, which contributed to greater shareholder attendance. Other shareholders expressed concern about the inability to see management and board members, as a large majority of virtual meetings in the 2020 proxy season were audio only. Some also expressed concern about a lack of transparency surrounding the Q&A sessions, as shareholders were asked to type their questions into the virtual meeting portal, which was only visible to the company, and shareholders could not see other shareholders' questions.
- While a large majority of virtual meetings during the 2020 proxy season were in audio-only format, we expect that in 2021 an increasing number of companies will incorporate video components for their meetings, as video conferencing capabilities have been enhanced during the pandemic.
- Given concerns raised by investors around these limitations, companies should consult virtual meeting service providers to understand how the platforms may be changing in 2021 and to express suggestions for additional features or enhancements that the company may want to include. With more time to plan, shareholders will be less forgiving and more insistent on opportunities to participate and on the transparency of the Q&A format. Relatedly, many investors continue to indicate a preference for hybrid meeting formats over virtual-only and companies should clearly disclose rationales for virtual-only formats, even during the continuing pandemic.

Consider SEC Staff Guidance

- While state corporate law governs the ability to hold a virtual shareholder meeting, the federal securities laws and SEC rules govern proxy disclosure. The staff of the SEC's Division of Corporate Finance and the Division of Investment Management (SEC Staff) in April issued helpful guidance for conducting shareholder meetings in light of COVID-19 concerns, addressing how companies should disclose changes to the date, time or location of a meeting, including a change from an in-person to a virtual meeting.
- The guidance suggested companies disclose "clear directions as to the logistical details of the 'virtual' or 'hybrid' meeting, including how shareholders can remotely access, participate in and vote at such meeting," and encouraged companies to provide proponents of shareholder proposals with the ability to present their proposals through alternative means, such as by phone.²³
- Given certain investor concerns about company disclosure on how to access virtual meetings, presentation of shareholder proposals and the transparency of Q&A sessions, it is possible the SEC Staff might issue further guidance on proxy disclosure requirements for those companies planning to hold virtual shareholder meetings in 2021.

²³ Staff Guidance for Conducting Shareholder Meetings in Light of COVID-19 Concerns (April 7, 2020), available [here](#).

Consider Proxy Advisory Firm Guidelines

- At the beginning of 2020, Institutional Shareholder Services (ISS) did not have a policy on virtual shareholder meetings. In April 2020, ISS issued guidance supportive of virtual meetings during the COVID-19 pandemic and encouraged companies to commit to returning to in-person or hybrid meetings as soon as practicable.²⁴ Glass Lewis suspended through June 30, 2020, its policy of voting against director nominees who serve on the governance committee of a company that holds virtual meetings without sufficient disclosure about shareholder participation rights.
- In its 2021 proxy voting policy guidelines, Glass Lewis removed the temporary exception to its policy on virtual shareholder meeting disclosure. Specifically, for companies choosing to hold their meeting in a virtual-only format, Glass Lewis expects robust disclosure in the company's proxy statement addressing the ability of shareholders to participate in the meeting. This includes disclosure of shareholders' ability to ask questions at the meeting; procedures, if any, for posting appropriate questions received during the meeting and the company's answers on its public website; and logistical details for meeting access and technical support. When such disclosure is not provided, Glass Lewis will generally hold the governance committee chair responsible.²⁵
- For 2021, ISS has adopted a policy in its U.S. benchmark guidelines regarding the format of annual meetings. ISS will generally support management proposals allowing hybrid shareholder meetings as long as the intention, in the absence of health or safety concerns, is not to hold virtual-only meetings to the preclusion of in-person meetings. ISS encourages companies to disclose the circumstances under which virtual-only meetings would be held and to afford shareholders the rights and opportunities to participate electronically comparable to those they would have during an in-person meeting. For shareholder proposals, ISS will review case-by-case proposals concerning virtual-only meetings, considering the scope and rationale of the proposal and any concern with prior meeting practices.²⁶

In 2021, given the uncertainties surrounding the pandemic, in addition to public safety guidelines and state orders, companies and boards should carefully monitor developments in state corporate law and SEC guidance and consider investor feedback and proxy advisory firms' guidelines as they plan for the proxy season. Contingency planning and flexibility will be key, and maintaining shareholder relationships through effective engagement during the off-season will be more important than ever.

²⁴ Institutional Shareholder Services (ISS) Policy Guidance, "Impacts of the COVID-19 Pandemic" (April 2020).

²⁵ Glass Lewis, "2021 Proxy Voting Policy Guidelines" (2020).

²⁶ Institutional Shareholder Services (ISS), "2021 Benchmark Proxy Voting Policies" (2020).



Report on Practices for Virtual Shareholder Meetings

Posted by Douglas K. Chia and Ann S. Lee (Rutgers Center for Corporate Law and Governance, The Society for Corporate Governance, and the Council of Institutional Investors)

Editor’s note: Douglas K. Chia is a fellow at Rutgers Center for Corporate Law and Governance, and Ann S. Lee is a JD candidate at Rutgers Law School. This post is an excerpt from the [report](#) of the 2020 Multi-Stakeholder Working Group on Practices for Virtual Shareholder Meeting, co-chaired by Amy Borrus, Executive Director of the Council of Institutional Investors, and Darla Stuckey, CEO of the Society for Corporate Governance.

The scope of this post comprises the conduct during the VSM and the related disclosures made before and after the meeting. It is designed to outline expectations, as well as evolving practices, for VSMs once a company has decided to hold its annual meeting using a VSM platform. It also highlights certain areas of the VSM experience. In this sense, **the post should be used as a guide for—but not an endorsement of—VSMs.**

There are many factors that each of the over 4,000 publicly listed companies in the U.S. should consider when deciding on the best format for its annual meeting, including available resources, nature of the items of business to be voted on, composition of the shareholder base, historical attendance, level of comfort with new technology, and shareholder appetite. Each company should look at its particular facts and circumstances, evaluate all of its options, and hold its annual meeting in a way that best serves the needs of the company and its shareholders.

A key area of concern raised by shareholders during the 2020 proxy season related to the degree of difficulty of entering a VSM. Beneficial owners faced unexpected hurdles to attend certain VSMs. These difficulties were the result of the limitations and technicalities of the complex system by which equity securities are held and voted in the U.S.—commonly referred to as “proxy plumbing.” The corporate governance community and securities regulators have long debated the workings of the proxy plumbing system, and discussions over the possibility of overhauling all or parts of it are on-going among industry groups.

Given that the selective difficulties with entering VSMs are unfortunate by-products of proxy plumbing, those issues are beyond the scope of this post. However, the 2020 Working Group was in strong agreement that solutions to proxy plumbing-related issues are essential for all shareholders entitled to vote at all VSMs, no matter which service provider “hosts” the meeting. Shareholders must be able to exercise their rights to attend and vote at shareholder meetings on an equal basis to maintain the integrity of corporate governance in the U.S.

Furthermore, this post is intended to address issues that relate specifically to virtual-only meetings. It does not discuss issues that relate to all shareholder meetings in general, regardless of whether they are in-person, hybrid, or virtual. Nor does it delve into the unique challenges that arise when a shareholder meeting must be held during a pandemic or other public emergency.

2020 Legal Landscape

Most states now permit virtual-only or hybrid shareholder meetings. Only five states require in-person meetings, and 45 states and the District of Columbia permit hybrid meetings. Thirty-three states, including Delaware, permit virtual-only meetings. (See Appendix C for a survey of state statutes.)

The landscape for the 2020 proxy season was constantly evolving due to the public health impact of COVID-19. Delaware issued an emergency declaration in April that allowed companies to change scheduled in-person meetings to a virtual-only format without having to re-notice the meetings as long as the companies filed a notice of the change with the SEC and posted a press release on their websites. New York, Massachusetts, and California released similar emergency orders in March suspending requirements associated with the switch to virtual-only meetings. Many other states that prohibited virtual-only meetings followed suit by granting temporary relief from in-person meeting requirements.

The SEC's staff issued limited guidance in March and April 2020 as to how to navigate the disclosure of virtual-only and hybrid shareholder meetings to support the health and well-being of board members, shareholders, and other constituencies. Companies were expected to communicate promptly any change in format from an in-person to a VSM, as well as communicate clear directions on the logistical details of the meeting, such as how shareholders could remotely access, participate in, and vote at the meeting. For issuers that had already mailed proxy statements for in-person meetings, the staff guidance indicated that they could change the format to a virtual-only or hybrid meeting without mailing additional solicitation materials if they (1) issued a press release announcing such change, (2) filed the announcement as definitive additional soliciting material with the SEC, and (3) took all reasonable steps necessary to inform other intermediaries in the proxy process (such as any service provider) and other relevant market participants (such as the applicable stock exchange) of such change. Many companies that had to make a decision in the early stages of the pandemic decided to notice the meeting again instead of risking the meeting being held on improper notice. Companies that were scheduled to have their meetings in later months were urged by the SEC's staff to evaluate their own circumstances and promptly make a decision on how to proceed. As noted above, several states, including Delaware, issued executive orders granting relief on notice obligations.

Types of Annual Meetings

In-Person

In-Person Only. This is the traditional annual meeting of shareholders that takes place at a physical location where registered and beneficial shareholders who are verified as such may attend the meeting and vote in person. Registered holders are also able to examine the list of registered holders at the meeting. A question and answer (“Q&A”) session, while not legally required, is standard practice. Some companies allow non-shareholders to accompany shareholder attendees as “guests,” but guests are not eligible to vote. Practices are mixed on whether guests are allowed to ask questions. Practices are also mixed on whether media is allowed into the meeting; if so, they typically are not allowed to ask questions.

In-Person with Live Internet Streaming. This is the traditional in-person annual meeting with the addition of live Internet streaming (audio-only, or audio with video) for non-attendees to listen/watch the proceedings of the meeting remotely. Shareholders and non-shareholders may access the web streaming through the Internet without any need for verification, but they are **not** counted towards a quorum or able to vote, ask questions (in most cases), or examine the list of registered holders. Some companies only stream the management presentation and formal (*i.e.*, legally required) portions of the meeting, but not the Q&A session.

Virtual (VSM)

This is an annual meeting that takes place **entirely** over the Internet (audio-only, or audio with video) with no ability to attend in person. Registered and beneficial shareholders are able to attend remotely and vote via a virtual (*i.e.*, online) platform upon being verified. As with the traditional in-person annual meeting, a Q&A session is standard practice, but only verified shareholder attendees are usually able to ask questions before or during the meeting, usually in writing. Most companies allow guests to attend the meeting through the virtual platform, and shareholders who do not wish to attend as verified shareholders may also attend as “guests.” Most companies do not allow guests to ask questions. Regardless of whether or not they are actually a shareholder, anyone attending as a guest will not count towards a quorum, and will not be able to vote or examine the list of registered shareholders during the meeting as they could if they attended as verified shareholders.

Hybrid

This is an annual meeting that gives shareholders the option to attend and participate either in person or remotely through a virtual platform. Unlike at in-person meetings with live Internet streaming, all verified shareholders, whether attending in person or remotely, can vote and ask questions during the meeting. Given the additional company resources required to accommodate both in-person and remote shareholder participants simultaneously, hybrid meetings have been rare to date.

Some investors believe that a hybrid meeting may be the optimal format for a shareholder meeting. Prior to the COVID-19 pandemic, these investors made statements and/or established policies indicating that, in the absence of the ability for a shareholder to attend an annual meeting in person, they may cast proxy votes against members of the board nominating committee of a company that holds a VSM.

Current Views of Shareholders and Companies

Shareholders

A large and vocal group of institutional shareholders has for many years voiced strong objections to VSMS as adversely impacting their ability to exercise their rights and directly express themselves to boards of directors. The overarching concern of these investors has been that, intentionally or unintentionally, VSMS shield the board and management from shareholder interaction as compared to in-person meetings, potentially undercutting their ability to hold management accountable. For these shareholders, their experiences at VSMS this year confirmed for them that a VSM is a wholly inadequate replacement for an in-person meeting, with

few opportunities for the interactivity and discussion they expect. Many of these shareholders expressed that their long-held concerns played out, most notably:

- General sense that companies had much tighter control over the structure and flow of the Q&A sessions than at in-person meetings, including a feeling that some companies were “cherry picking” innocuous questions and favorable comments over difficult questions and critiques.
- Apprehension created by a lack of transparency about certain companies’ use of discretion to combine or paraphrase similar questions or reword questions.
- Suspicion that some questions asked and answered during the Q&A sessions at certain companies were generated by the companies themselves, as opposed to verified shareholders, with rehearsed answers from the meeting chairs as a way to avoid difficult questions and fill the time allotted for Q&A.
- Inability for shareholders to ask follow-up questions the way they could at in-person meetings.
- Loss of opportunities for shareholders to interact with eye contact, both formally and informally, with board members, company executives, and other shareholders.

This left many of these shareholders feeling that the role of shareholder participation in annual meetings had been either inadvertently overlooked or intentionally marginalized.

As in prior years when most annual meetings were in-person, shareholders had a wide range of experiences at VSMs in 2020, from meetings that were called to order and adjourned in under ten minutes to ones that lasted several hours with hundreds of participants. However, the quick transition that companies had to make during the pandemic to hold VSMs led most to simplify their meetings to the extent possible to ensure successful execution in the midst of unprecedented circumstances—particularly fear of technological problems derailing the meeting. The transition also created confusion and unanticipated challenges for shareholders to attend many of the VSMs.

At some VSMs, shareholders wishing to ask questions were not given clear instructions on how to submit their questions during the meeting. Unlike at in-person meetings, questions had to be submitted in writing and were then read (or paraphrased) by management.

To be sure, some shareholders had a more favorable view of VSMs this year. They appreciated the ability to attend, present proposals and ask questions at many more meetings, and to ask more questions than they typically are able to ask at in-person meetings (where most companies limit the number questions from any one shareholder). However, despite these positives, many shareholders expressed that the VSM continues to be an inadequate replacement for an in-person meeting, as it simply cannot replicate the in-person experience from the shareholder’s point of view.

Shareholder Proponents

Overall, shareholder proponents reported that they were able to present their proposals without difficulty and described companies as treating them with professionalism and respect. Many companies gave the investors a choice as to how they would like their proposal presented; and in

some cases, the companies had written statements or pre-recorded statements as “belts and suspenders” in case a proponent’s telephone line or Internet connection was dropped.

However, in at least one instance, shareholder proponents were not afforded the ability to present the proposals in their own voice; instead they had to submit written statements that company representatives read aloud during the meeting.

Companies

Historically, companies have expressed few objections to the concept of the VSM, even though the overwhelming majority of them preferred to hold their annual meetings in person. Many saw the VSM as potentially an attractive option should the situation arise that necessitated such a format. Prior to the COVID-19 pandemic, those that did hold VSMs cited the “environmentally friendly” aspects of online events, greater convenience for an expanded pool of shareholders to participate in corporate governance, and uniform and more consistent experience for all attendees.

In general, companies using VSM platforms for the first time in 2020 reported a positive experience. While the risk of technological failure was real, glitches were minimal while shareholder attendance increased. The associated costs were also generally lower in comparison to in-person and hybrid meetings that require procurement of physical venues, security, catering, and other accommodations. But some companies that have historically held their annual meetings at their own headquarters with few attendees reported that the cost for them to hold a VSM was greater. Some governance professionals believed that questions submitted by shareholders at VSMs were more substantive and of “higher quality” than at in-person meetings.

The downsides to the VSM noted by companies primarily related to the increased coordination required of the company representatives running the meeting and managing the Q&A sessions. Those running the meeting had to communicate with each other during the meeting from different locations—attributable solely to the COVID-19 restrictions (not VSM technology). Being in different locations led directors and management to use one or more communication platforms, such as text message and online collaboration tools, in parallel with the VSM platform to interface with each other during the VSM since they were not in the same room. Not all were adept at using each of these digital platforms or multitasking during the meeting, and the learning curve was steep. Concerns around coordination required additional time to prepare and rehearse. Companies with meetings that included shareholder proposals also had to coordinate in advance of and during the meeting with these additional remote participants who had speaking roles, but were external to the company.

While overall the average number of questions that companies received at annual meetings in 2020 was not dramatically different than in previous years, companies had to adjust to a new way of receiving questions, as VSM platforms generally allowed shareholders to submit questions in writing throughout (and in many instances before) the meeting. In addition, any shareholder was able to submit multiple questions, in many instances anonymously. Companies that have historically held in-person annual meetings had been accustomed to calling on shareholders in the audience who raised their hands or approached a standing microphone, and companies usually limited the number of questions each shareholder could ask.

Applying the 2018 Report to 2020

Companies for the most part followed the spirit of the principles established by the 2018 Committee during the 2020 proxy season. The 2020 Working Group agreed that the guiding principles from the 2018 Report remain generally accepted across key stakeholder groups and thus remain valid for the immediate future:

- Broad investor participation in annual meetings should be valued and encouraged.
- Shareholder meetings should promote equitable and equal treatment of investor participants.
- Opportunities for meaningful engagement between investors and boards should be provided.
- Issuers should communicate the benefits of a VSM to shareholders.
- VSMs should be used as a way to provide meaningful open dialogue between shareholders and companies.

Regarding the “Best Practices” outlined in the 2018 Report, the 2020 Working Group found that after observing almost 2,500 VSMs conducted in one proxy season, a number of practices that were considered best practices in 2018 became standard practices in 2020. The 2020 Working Group also determined that some emerging practices that were not widely adopted by companies in 2020 should be more strongly encouraged for VSMs in 2021 and beyond in hopes that they will become standard practices. The 2020 Working Group understood that the evolution of standard practices will be driven by the continual enhancement and innovation in VSM technologies and lower costs, as well as the learning curve for companies and their shareholders.

Trends in VSM Practices

There were numerous VSM practices during the 2020 proxy season that shareholders will likely expect companies to treat as standard going forward, absent difficult circumstances. There were other practices that appeared to be evolving in ways that indicate they will likely become standard in the relatively near- term, especially as VSM technology continues to improve and become more affordable for companies of all sizes. This section of the 2020 Working Group Report combines these practices in a way that provides companies specific, practical, and usable guidance on how to conduct a VSM, understanding that not all companies will be able to adopt all of these practices at once. In this sense, this set of practices taken as a whole can be seen as aspirational for now.

Disclosure

Instructions on How Shareholders Can Attend and Participate

Companies have a responsibility to provide clear and comprehensive instructions in proxy statements and related disclosure on how their shareholders can participate in their shareholder meetings. Therefore, it is incumbent upon the company holding a VSM to:

- Provide shareholders with complete, detailed instructions on how they can attend the meeting and vote prior to and at the meeting.
- Write these instructions in “plain English” with the individual retail shareholder in mind.

- Place these instructions in a prominent and easily located place in the proxy statement for the meeting.
- Clearly distinguish and explain the different procedures for shareholders of record and shareholders holding shares in “street name” (e., beneficial holders), if applicable.
- Highlight whether and why a shareholder must obtain and/or provide additional information (g., separate control number, legal proxy) in advance of the meeting and how to do so.
- Indicate whether attendance is limited to shareholders or open to both shareholders and guests.

Instruction on How Shareholders Can Submit Questions

While it is not explicitly a legal right, shareholders expect to be able to ask questions at shareholder meetings, and companies have long included time for questions from shareholders at their annual meetings. Companies frequently have meeting rules distributed at in-person meetings, and this should be no different for VSMs. Thus, prior to their VSMs, companies should:

- Provide instructions on how and when shareholders will be able to ask questions at the meeting.
- Make it clear that a shareholder must attend as a verified shareholder (e., not as a guest) to be eligible to ask questions (and vote) at the meeting.
- Explain any requirements or limitations on asking questions at the meeting (g., time allotted for the Q&A session, time allotted per question, number of questions allowed for each shareholder, self-identification) and how the company may use discretion when selecting questions to answer and paraphrase questions for greater clarity.
- Explain whether and how the company will respond to any questions after the meeting that it was not able to answer at the meeting.
- If the company chooses to solicit questions in advance, provide instructions on how shareholders can ask questions in advance of the meeting.

Reasons for Using a Virtual-Only Format

As VSMs have not been the norm and have been used very infrequently before the COVID-19 pandemic, shareholders should receive an explanation of why the company has chosen this format for the particular meeting. The company may have different (and multiple) reasons for holding a VSM in a particular year. Thus, companies using a VSM format should:

- Explain in the proxy materials why the company has elected to hold the meeting using a VSM format instead of in-person.

Preparation

Company Training and Rehearsals

As with all planned events, it is important for those directly involved with the VSM to execute their duties, know what to expect, and anticipate and work out as many potential technical and communications difficulties as possible well in advance. To that end, the company should:

- Ensure adequate training on the VSM platform for any board members, company representatives, and contractors who will be actively working on or participating in the meeting.
- Ensure technical support staff is present during the meeting in case technical challenges arise.
- Rehearse the entire meeting with the individuals who will be actively working on the meeting.
- Ensure the adequacy and functionality of all means for the individuals who will be actively working on the meeting to communicate with each other during the meeting.

Communication with Shareholder Proponents

Preparation for any shareholder meeting should include direct communication with any shareholders that have proposals to be voted on at the meeting. For VSMs, it is important that shareholder proponents are given access to the meeting for them to formally present their proposals, be heard clearly and uninterrupted by all attendees, and be fully able to participate in any Q&A session. To that end, companies should:

- Coordinate with proponents in advance of the meeting to discuss the logistics of presenting their proposals and subsequently asking questions.
- Provide proponents with a dedicated phone or video connection to present their proposals in real time at the (Test the connection on both sides in advance for any background noise, lags, or glitches.)
- Give proponents the option to provide a pre-recorded statement that the company will play, or a written statement for management to read aloud, at the meeting in lieu of virtual attendance.
- Ensure proponents are aware of the meeting agenda, when their proposals will be introduced, how they will know when to speak, any time or length limitation for their statements, and other instructions needed for proponents to present.
- Discuss contingency plans in the event the proponent faces technical difficulties attending the meeting (such as providing a pre-recorded or written statement to the company as a backup).

It is also important, and in their best interest, for ***shareholder proponents*** to make themselves available and be cooperative with advance preparation requests.

Allowing Shareholders to Test Internet Connectivity

As with any webcast or virtual meeting, there may be instances where attendees are not able to access the event easily due to inadequate technical capabilities that could have been resolved had they been tested in advance. To that end, companies should:

- Provide a simple way for attendees to check the online system compatibility requirements (*g.*, operating system, web browser, and Internet connection strength) to connect to the VSM and minimize the likelihood of connection issues well in advance of the meeting.
- Allow attendees to login at least 15 minutes before the scheduled start time to resolve connection issues.

VSM Platform

Audio or Video Format

Most VSMS thus far have been audio-only, where the meeting chair and other company participants and shareholder proponents can be heard, but not seen, by attendees. A number of companies have been conducting their VSMS with both audio and video, where the meeting chair and company participants are shown live and in real time from a studio or meeting room, replicating how an in-person meeting would look. However, the pandemic caused most of these companies to also conduct their VSMS using only audio.

The hope of investors in the 2020 Working Group is that an increasing number of VSMS will use video (absent pandemic-like restrictions). The companies' view is that video can be considered only as production costs and risks of complications decrease, production standards change, and VSM platforms enable multiple people to appear on the platform by video from different locations. To maximize the effectiveness of remote communication, companies should:

- Weigh the costs and benefits of using video versus audio-only technology for the VSM with the aspiration to use video in some capacity.

Voting

Voting is a shareholder's most important and powerful right. To that end, companies must:

- Provide a prominently visible and simple mechanism on the main VSM page for shareholders to vote their shares (and change their votes if desired) during the time the polls are open.
- Confirm that the VSM service provider is able to maintain the integrity of, and the inspector of election is able to certify, the votes cast at the meeting.

Questions

At an in-person meeting, questions are usually not solicited until the Q&A session begins, which is typically after consideration of the official items of business and any management presentations.¹ During an in-person Q&A session, shareholders asking questions are recognized from the floor by the meeting chair and are seen and heard by the company and the other attendees. Most companies require shareholders to identify themselves before speaking.

For VSMS, the process for submitting questions is very different. VSM platforms usually provide a space for shareholders to type and submit questions during the meeting, and the company will collect those questions and then read and address them during the Q&A session (as time permits). To replicate as closely as possible what an in-person Q&A session accomplishes, companies should:

- Provide a prominently visible and simple mechanism on the main VSM page for shareholders to submit questions to the company throughout the meeting.

- Clearly instruct shareholders that when submitting questions, they must identify themselves and provide contact information in case the company needs to address their question after the meeting.
- Request that the VSM service provider make all questions visible to the company verbatim and in real time.
- Request that the VSM service provider authenticate the identity of the shareholder asking the question.

(Also see “Proceedings of the Meeting—Q&A Session” below.)

Posted Content

It is essential that shareholders have all material information needed to make a voting decision. Also, most states require companies to make the list of shareholders of record entitled to vote available to shareholders of record at the meeting for inspection during the meeting.

- Post complete and downloadable copies of the meeting agenda, rules of order, and all proxy materials for the meeting in a prominent location on the main VSM page.
- Provide a clear way for registered shareholders in attendance to be able to examine the list of registered shareholders entitled to vote, if required by and in accordance with the laws of the company’s jurisdiction of incorporation.

Assistance for Attendees

As with any webcast or virtual meeting, there may be instances where attendees will face technical difficulties and seek immediate assistance during the meeting. That may be especially true for individual retail shareholders who have never attended an annual meeting, whether in-person or virtually, or who are not proficient with the technology of virtual meetings. Companies using a VSM platform should:

- Provide information in advance of the meeting (*g.*, in the proxy statement) for how shareholders can contact the company or the VSM service provider with questions about attending the meeting.
- Provide a visible mechanism on each page of the VSM platform for attendees to contact a live operator for assistance via phone, online “chat” function, or other form of real-time communication.

Proceedings of the Meeting

The formal legal portion of a VSM should be conducted in the same manner as any in-person shareholder meeting, with certain modifications or enhancements described below to make the virtual experience for the shareholder as close as possible to an in-person shareholder meeting.

Announcements

At any large meeting, it is important to provide clear guidance on how the meeting will be conducted and instructions for how to participate. This may be even more important at virtual

events. In addition to the announcements traditionally or required to be made at annual meetings, companies should announce immediately after the meeting is called to order:

- Instructions on how to vote during the meeting through the VSM site;
- Availability of proxy materials on the VSM site;
- Instructions on how and when to submit questions during the meeting and how and when they will be answered (including the need for questioners to provide their name and contact information); and
- Information for attendees requiring technical or other assistance.

Shareholder Proposals

Filing shareholder proposals is an important way for shareholders to express their concerns to the board and to other shareholders. Shareholder votes on these proposals measure the level of support for the board to act in accordance with prevailing shareholder sentiment on key issues. To ensure that shareholder proponents are able to present their proposals properly at shareholder meetings, companies should:

- Encourage the proponent to connect to the meeting through a dedicated line before the meeting begins.
- Be clear in instructing the proponent when to begin his/her remarks, how much time is allotted to him/her and what will happen when the allotted time is over.
- Ensure that the proponent can clearly hear the chair and be heard by the attendees throughout his/her remarks (to the extent it is within the company's control).
- Ensure that any pre-recorded or written remarks provided by the proponent in lieu of attendance are made audible with the same sound quality as the rest of the meeting (to the extent it is within the company's control).

In addition, it is important that ***shareholder proponents*** adhere to the rules of order for the meeting and interact with company representatives in a cooperative and constructive manner. As most companies have not conducted many VSMs, proponents should be patient and flexible if legitimate technical issues arise.

Q&A Session

For many shareholders, a company's annual meeting is the only opportunity they will have to address questions and comments to the company's board of directors and shareholders, directly and in front of all of the company's shareholders in attendance. In that sense, the annual meeting is an important event for shareholders to engage directly with boards and management, as well as other shareholders. To this end, companies should:

- Allocate ample time on the agenda for Q&A based on the number of questions submitted in advance and reasonably anticipated to be received during the meeting.
- Explain how much time will be dedicated to the Q&A session and how the company will handle questions it may not be able to get to before time expires.
- Explain in what order the company will be reciting and answering the questions submitted.

- Note whether the company will take multiple questions from a single shareholder, and if so, in what order.
- Identify each questioner before reciting his/her
- Recite, to the best of its ability, each question verbatim as submitted by the shareholder, rewording or paraphrasing the shareholder's submission only when necessary to make it comprehensible.
- If answering once for multiple questions on the same topic, indicate that other shareholders submitted the same or a substantially similar question.
- Have members of the executive team and board committee chairs, in addition to the board chair (or lead director) and CEO, in attendance with the ability to audibly answer questions during the Q&A session as appropriate.
- Address all, or substantially, all questions received in advance of the meeting (if the company elects to solicit questions in advance).

In addition, ***shareholders asking questions*** should comport themselves with due respect for the meeting and other shareholders wishing to ask questions. In that regard, shareholders posing questions should:

- Follow the rules of order for the meeting and refrain from disruptive behavior, verbal abuse, and personal attacks unrelated to the company or board members, executives or other employees, or other shareholders.
- Keep questions and comments germane to the company and not raise personal grievances.

After the Meeting

After the meeting (within a reasonable period of time), the company should:

- Post on its website a recording of the entire meeting (including the Q&A session) for public viewing for a specified, extended period of time.

Optional and Emerging Practices

In addition to the standard and evolving practices described above, it is worth noting certain other practices that some companies used to enhance their VSMS. Companies should be encouraged to experiment with innovative practices and different types of digital communication to enhance the VSM experience for their shareholders.

- Posting all VSM instructions and related content, including what can be found in the proxy materials, on the company's website at the same time or promptly after the company files the definitive proxy materials with the SEC.
- Posting all questions received both before and during the meeting, and corresponding answers, on the company's website within a reasonable period of time after the meeting.
- Posting a transcript of the full meeting (including Q&A session) on the company's website within a reasonable period of time after the meeting.
- Providing a live video feed of members of management² and the board.
- Allowing shareholders to call in to ask questions and be heard in real time.

- Extending the time of the meeting to answer questions submitted.
- Providing closed captioning or signing for the hearing impaired.
- Providing real-time translations into multiple languages.
- Giving shareholders the ability to see all appropriate questions submitted in advance of the meeting and in real time and track prioritization of the questions in the queue throughout the meeting.
- Giving shareholders the ability to indicate their level of interest in particular questions shown in the queue.
- Allowing shareholder proponents and questioners to appear on video.

The complete publication, including footnotes, is available [here](#).



Virtual Shareholder Meetings in the 2021 Proxy Season

Posted by Marc S. Gerber, Richard J. Grossman and Khadija Lalani, Skadden, Arps, Slate, Meagher & Flom LLP, on Tuesday, October 13, 2020

Editor’s note: Marc S. Gerber and Richard J. Grossman are partners and Khadija Lalani is an associate at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum.

The COVID-19 pandemic has impacted U.S. public companies in myriad ways. The fact that the traditional proxy season—the period from April through June when a substantial number of public companies hold their annual meetings—took place at all is a credit to the collaborative efforts and flexibility of many different participants in the proxy ecosystem, including companies, boards of directors, corporate secretaries, state governments, the Securities and Exchange Commission (SEC), various service providers, proxy advisory firms and investors. The outcome was a monumental shift from a proxy season of traditional in-person annual meetings of shareholders to one largely of virtual shareholder meetings.

Considering the lack of planning time and the haste with which this systemic pivot occurred, the virtual meeting proxy season should be considered a resounding success. Companies were able to conduct their annual meetings mostly on schedule while observing the necessary restrictions and guidelines on public gatherings, thereby protecting the health of shareholders, employees, directors and other annual meeting participants. Investors were able to attend and participate in annual meetings without traveling or gathering in large groups and could even attend multiple meetings in a single day, resulting in greater shareholder attendance. That said, at least some investors remain concerned about a lack of transparency surrounding virtual shareholder meetings—particularly due to the fact that only the company was able to see the questions shareholders asked during Q&A sessions—and have called virtual meetings a “poor substitute” for in-person meetings.

Looking ahead, uncertainty relating to COVID-19 remains; however, companies have more time to consider and plan for the possibility—or even the likelihood—of virtual shareholder meetings for the 2021 proxy season. As part of this planning process, companies may want to engage with their shareholders now, during the “off season” shareholder engagement period that runs from September through December or early January, to obtain investor feedback on the virtual shareholder meeting process. Doing so may inform company decision-making, proxy disclosures and perhaps implementation of “virtual proxy season 2.0.”

As was the case for 2020, 2021 annual meeting planning and decisions around holding an in-person or a virtual annual meeting will require companies to consider—in addition to public health and employee safety concerns, and government recommendations and restrictions on public gatherings—state corporate law, corporate governance documents, SEC rules and guidance, and proxy advisory firm and investor viewpoints and policies. Also, companies should engage early

with virtual meeting service providers to understand how virtual meeting platforms may be evolving in response to both company and investor feedback.

State Corporate Law and Corporate Governance Documents

The starting point for a company considering conducting a virtual shareholder meeting is to take into account the laws of the state in which it is incorporated. The majority of states, including Delaware, permit companies to hold virtual-only shareholder meetings.

Many of the states that otherwise would have required an in-person meeting, or at least an in-person component (*i.e.*, a hybrid meeting that allows for both in-person and virtual attendance), provided relief in 2020 through a combination of executive orders and/or amendments to the governing statutes. However, the status of this relief for 2021 annual meetings is uncertain. For example, for New York corporations, virtual-only shareholder meetings are allowed only for as long as the current state of emergency remains in place. Similarly, New Jersey corporations are permitted to hold virtual-only shareholder meetings only when the governor has declared a state of emergency. Companies incorporated in states such as these will have to engage in additional contingency planning to account for the risk that a virtual-only meeting permitted when the company files its proxy statement may no longer be permitted by the date of the 2021 annual meeting.

Most companies holding virtual-only shareholder meetings in 2020 reviewed their corporate governance documents and made any changes necessary to utilize emergency or similar relief provided from state restrictions on virtual-only shareholder meetings. Companies should continue to monitor developments in their state of incorporation and review their corporate governance documents in light of any potentially relevant statutory changes or new executive orders.

SEC Staff Guidance

Although the ability to hold a shareholder meeting virtually and questions on the conduct of the meeting itself are governed by state corporate law, the federal securities laws and SEC rules govern proxy disclosure as well as the inclusion of certain shareholder proposals in a company's proxy materials. The staff of the SEC's Division of Corporation Finance (Staff) issued helpful guidance early in the 2020 proxy season reminding companies contemplating virtual shareholder meetings to "disclose clear directions as to the logistical details of the [meeting], including how shareholders can remotely access, participate in, and vote at such meeting." The guidance also addressed how companies should disclose changes to the date, time or location of a meeting (including switching from an in-person to a virtual meeting) and encouraged companies to provide proponents of shareholder proposals or their representatives "with the ability to present their proposals through alternative means, such as by phone, during the 2020 proxy season."

Certain investor groups have written to the Staff to express their concerns regarding virtual shareholder meetings. These concerns relate to disclosure about how shareholders can access virtual meetings, the presentation of shareholder proposals, and the transparency and conduct of Q&A sessions. It is possible that the Staff could issue further guidance for companies planning to hold virtual shareholder meetings calling for additional or expanded proxy disclosure in these areas.

Proxy Advisory Firms and Investors

Institutional Shareholder Services (ISS) does not have a policy of voting against companies holding virtual shareholder meetings. In April 2020, ISS issued guidance that was supportive of virtual meetings during the pandemic and encouraged companies to commit to returning to in-person (or hybrid) meetings as soon as practicable. As part of its recently completed annual survey, which often informs its views of potential benchmark voting policy changes for the upcoming proxy season, ISS sought feedback on whether to maintain the guidance for 2021 and on the topic of virtual shareholder meetings more generally. Updated ISS policies for the 2021 proxy season likely will be published in November or December 2020, and companies should review them for any updates relating to virtual shareholder meetings.

Glass Lewis' current policy, which precedes the COVID-19 pandemic, recommends voting against director nominees who serve on the governance committee of a company that holds virtual-only meetings without sufficient disclosure about shareholder participation rights. Glass Lewis effectively suspended this policy through June 30, 2020. How the firm will apply this policy going forward remains to be seen, as does the question of whether it will expand the policy to seek additional meeting procedures or disclosures for virtual shareholder meetings heading into 2021. Updates to Glass Lewis policies also are likely to be published in November or December 2020.

Early in the 2020 proxy season, a number of investors and investor groups, including some that were previously opposed to virtual shareholder meetings, voiced support for them in light of the pandemic. How they approach this topic in 2021, informed by their own experiences and those of other investors during the 2020 proxy season, is to be determined. Accordingly, companies may want to solicit feedback from their investors in order to incorporate that feedback into the decision-making for the 2021 annual meeting format. Some investor concerns may be addressed easily by enhancing proxy disclosure, while others may impact how companies conduct the meeting. At a minimum, the ability to include proxy disclosure relating to shareholder engagement on this topic and describing steps taken to be responsive to the feedback has the potential to mitigate negative reactions from proxy advisory firms or investors that are less accepting of virtual shareholder meetings in 2021.

Virtual Meeting Service Providers

Finally, companies should speak with virtual meeting service providers to understand how the platforms may be evolving, as well as to express company preferences for enhancements the company might wish to include. For the 2020 proxy season, the vast majority of virtual meetings were audio rather than video, and shareholders generally typed their questions into the virtual meeting portal, meaning only the company saw them. Some shareholders expressed dissatisfaction with being unable to see management and the board members during the meeting, and with the inability to see or hear questions from other shareholders. Given greater time to think through and plan for a virtual shareholder meeting, some companies may implement additional preferences that were not feasible in the hectic pivot to virtual meetings in 2020.

Conclusion

Although the future of the COVID-19 pandemic and the prospects for in-person shareholder meetings are unclear, companies have the ability to plan for virtual shareholder meetings in a more orderly and methodical fashion than they did for 2020 meetings. A company's own preferences, investor feedback, proxy advisory firm policies, state corporate law matters, SEC guidance and platform offerings by virtual meeting service providers may inform a company's decision-making and proxy disclosure going forward. As a result, it is possible that virtual shareholder meetings could look different in 2021 than they did in 2020.



Preparing for Shareholder Activism in the Wake of COVID-19

Posted by Keith E. Gottfried, Morgan, Lewis & Bockius LLP, on Monday, November 30, 2020

Editor’s note: Keith E. Gottfried is partner at Morgan, Lewis & Bockius LLP. This post is based on his Morgan Lewis memorandum. Related research from the Program on Corporate Governance includes [Dancing with Activists](#) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum [here](#)).

The shock, turmoil, uncertainty, and lack of visibility that followed the immediate onset of the coronavirus (COVID-19) pandemic in March 2020 were significant factors accounting for why shareholder activism was relatively subdued during the 2020 proxy season. However, given that activist investors have now had more than eight months to acquire their “sea legs” and recalibrate their playbook for the evolving “new normal,” it is likely that, even as the COVID-19 pandemic shows no signs of abating, activist investors will be less reluctant to wage an activism campaign in whatever “new normal” we find ourselves in during the 2021 proxy season.

Notably, unlike with respect to the 2020 proxy season, activist investors currently planning for the 2021 proxy season are making those plans aware of the existence of the COVID-19 pandemic and its evolving implications and having to anticipate and incorporate into their plans the possibility that, even if the current COVID-19 case surge is reversed and further extended lockdowns are avoided, the COVID-19 pandemic is not likely to materially subside between now and the end of the 2021 proxy season. In addition, as we will discuss below, we are likely at a point where the COVID-19 pandemic may be more of a catalyst for shareholder activism than an inhibitor. Accordingly, companies should not expect that shareholder activism during the 2021 proxy season will be as subdued as it was in 2020.

Current Situation

While the 2021 proxy season for companies with calendar year-ends is still months away, this is the time of the year when activist investors are planning whatever campaigns they may want to wage in 2021. In that regard, now is the time when activist investors identify their targets, if not already identified, and begin to engage with companies and their boards and/or management teams. On an almost daily basis, we are seeing activist investors file Schedule 13Ds with the US Securities and Exchange Commission (SEC) disclosing their acquisition of more than 5% of a company’s outstanding shares and their intent to be active with regards to such company. In some cases, the filing of the Schedule 13D is intended to place pressure on the company, its board of directors, and its management team to engage with the company. To the extent that activist investors are not successful through such engagement in getting companies to make the changes requested by the activist investors, then as we move closer to the end of 2020, activist investors will need to begin preparing advance notices of nomination to submit to companies to inform them of intended nominee slates to be presented at 2021 annual meetings. To be clear,

while many activist investors would likely be finalizing their plans prior to year-end with regards to what companies they want to engage with and possibly wage a campaign against, they still retain a great deal of optionality and remains months away from being fully committed to wage any campaign at any company.

As we move closer to the 2021 proxy season, what remains unclear is how the ongoing COVID-19 pandemic will ultimately impact shareholder activism and the campaigns that activist investors will wage during the 2021 proxy season. More than eight months have elapsed since heightened concerns with the COVID-19 pandemic began to take hold and much of the world transitioned to a work-from-home environment in response to state and local government mandates that businesses close their physical locations and people adopt previously unheard of social distancing practices that foreclosed many theretofore typical forms of in-person social interaction. While there has been some hopeful reports that pharmaceutical companies are moving closer to developing effective COVID-19 vaccines, the ultimate timing for when such vaccines could be approved, commercialized, and distributed remains unclear.

It also remains unclear when we can expect to be on path to some semblance of normality. In the near-term, the COVID-19 pandemic shows no signs of abating any time soon as the United States exceeds 11 million COVID-19 cases and moves closer to 250,000 deaths caused by COVID-19. Over the past eight months, the COVID-19 pandemic has destroyed countless lives, businesses, and livelihoods, upended numerous industries, and caused extensive turmoil across the world. Never before have we seen a crisis engulf the entire world all at once. During the early months of the COVID-19 pandemic, government mandates forced numerous businesses to reduce or suspend operations and while many, but not all, businesses have since reopened, even today, numerous businesses have yet to resume normal pre-pandemic operations. The large-cap market indices like the Dow 30 and S&P 500 have recovered from the COVID-19 driven stock market crash we saw this past March, and, in the wake of the recent election of President-elect Joseph R. Biden, have tested new record highs. However, the “rising tide has not lifted all boats,” and the Russell 2000, while in positive territory for the year, significantly lags behind the large-cap market indices as investors show a clear preference for large-caps, particularly large-cap technology companies that are more optimally positioned to execute in a work from home contactless environment.

To persevere through the COVID-19 pandemic and counter the loss of revenue caused by the related government mandated shutdowns and/or reduction of operations, companies have had to be creative and resourceful in pivoting their business models more in the direction of contactless commerce, developing alternative revenue streams, and preserving and identifying new sources of liquidity. The COVID-19 pandemic has also impacted demand and accelerated the shift to ecommerce and contactless commerce that had begun pre-pandemic. Not all companies have businesses easily adaptable to contactless commerce and, in some cases, their business model was historically dependent on bringing large groups of people together in relatively crowded environments. Numerous companies, unable to adapt their businesses to contactless commerce and not able to access sufficient liquidity to sustain them until a “new normal” emerges that is more akin what existed pre-pandemic, have been pushed into bankruptcy and/or liquidation and almost not a day goes by when we do not hear of a familiar company name heading towards or filing for bankruptcy and/or liquidation. In some of these cases, but certainly not all, the company may have already faced significant challenges pre-pandemic juxtaposed with a large debt burden, but the pandemic was the ultimate “nail in the coffin.” While many companies have been able to

rebound from the pandemic and, in some cases, thrive, the future is very uncertain for companies that are still limited in resuming operations or where demand has been adversely impacted by COVID-19 health and safety concerns.

Shareholder Activism Stats for the 2020 Proxy Season

While shareholder activism during the 2020 proxy season did not come to a sudden halt, it was certainly down when compared to 2019. Below are some key stats demonstrating how activism in 2020 compared with 2019:

- 652 activist investor demands worldwide (as of the end of Q3 2020), 105 fewer than in Q3 YTD for 2019 and the lowest level since 2015 ¹
- 367 activist investor demands at US companies (as of the end of Q3 2020), 45 fewer than in Q3 YTD for 2019 ²
- 247 proxy fights worldwide (as of October 31, 2020), compared to 259 for full year in 2019 ³
- 87 proxy fights at US companies (as of October 31, 2020), compared to 97 for full year in 2019 ⁴
- 169 board seats gained by activist investors in the US (as of the end of Q3 2020), 10 fewer than in Q3 YTD for 2019 ⁵
- Large caps in US (more than \$10B) were 35% of targets, a higher percentage than in the previous three years, showing activist investors' growing preference for large caps ⁶

More anecdotally, like so many other activities that were reshaped by the COVID-19 pandemic, shareholder activism during the 2020 proxy season was relatively subdued such that even the activism campaigns that went the distance or at least made it past the point where preliminary proxy statements for a contested shareholders' meeting were filed with the SEC had the "volume turned down." Given all the uncertainty that the world was confronted with from March 2020 onwards, one may wonder why there was even as much shareholder activism as there was. One reason for that is that many advance notice deadlines for the receipt of director nominations and shareholder proposals had closed by the time that concerns with COVID-19 began to take hold during the beginning of March 2020. As such, by the time COVID-19 was declared a pandemic, activist investors planning campaigns for the 2020 proxy season had already decided on which companies to target, had likely begun their engagement with company management and/or boards of directors, and had already submitted advance notices to their targets disclosing their intention to nominate director candidates and/or bring other business at the company's 2020 annual meeting. That does not mean that activist investors were fully committed to waging a campaign all the way to a shareholder vote, but it does explain why, while shareholder activism in 2020 was down from the prior year, the COVID-19 pandemic did not cause shareholder activism to come to a sudden halt.

¹ Activist investor Insight

² Activist investor Insight

³ FactSet Research, Inc.

⁴ FactSet Research, Inc.

⁵ Activist investor Insight

⁶ Activist investor Insight

How COVID-19 Impeded Shareholder Activism During the 2020 Proxy Season

As discussed above, while the COVID-19 pandemic did not cause shareholder activism to come to a sudden halt during the 2020 proxy season, COVID-19 certainly appears to have impeded shareholder activism in the following ways:

- Activist investors, like the rest of us, were confronted with unprecedented uncertainty and lack of visibility
- Activist investors were not insulated from the impact of COVID-19 on their investments and operations
- Lack of precedent for activist investors waging campaigns during a global pandemic and related economic shutdown
- Activist investors faced challenges in engaging with company boards and management teams
- Activist investors faced challenges in engaging with investors
- Activist investors faced challenges in pursuing a proxy contest at a virtual shareholders' meeting
- Possibility that activist investors would have been perceived as “tone-deaf” to the COVID-19 pandemic and the unprecedented challenges that companies were dealing with if they waged a campaign
- Limited ability for activist investors to criticize company performance in the immediate aftermath of an unprecedented pandemic and related economic shutdown
- Limited ability for activist investors to articulate a credible strategy for enhancing shareholder value in the immediate aftermath of COVID-19 as various popular value enhancement options fell out of favor
- Possibility that activist investor-driven board changes would not be as attractive to investors as they would be in the absence of the COVID-19 pandemic

Activist Investors Were Confronted with Unprecedented Uncertainty

As we headed into the 2020 proxy season, activist investors were confronted with unprecedented uncertainty. One would likely have to look back to World War II, some 80 years ago, for the last time when so much of the world was engulfed with a shared sense of uncertainty across multiple dimensions. Given that most activist investors were born long after that time, none has had to operate in an environment of such widespread uncertainty and lack of visibility. While many activist investors are extremely sophisticated and often reluctant to show any fear, activist investors are not immune from the same fears and concerns that were then impacting the rest of the world.

The uncertainties that faced activist investors during the 2020 proxy season included the following:

- Uncertainty as to duration of the COVID-19 pandemic
- Uncertainty as to the duration of the stay-at-home orders and nonessential business closures mandated by state and local governments
- Uncertainty as to when businesses would be able to resume operations, particularly those that were not easily adaptable to contactless commerce

- Uncertainty as to whether certain industries had been irreparably damaged
- Uncertainty as to whether certain business models had been irreparably damaged
- Uncertainty that consumer behavior had been irreparably changed and was continuing to change and how that would impact companies, industries and sectors
- Uncertainty in assessing companies' liquidity needs, given the uncertain duration of the COVID-19 pandemic and the related stay-at-home orders and nonessential business closures mandated by state and local governments
- Uncertainty that companies seeking liquidity would need to secure financing on less than attractive terms, including equity financing that may be highly dilutive
- Uncertainty as to how involved the US government would become in many industries that received government assistance to stay afloat and recover
- Uncertainty as to the outcome of the US presidential election

Activist Investors Were Not Insulated From the Impact of COVID-19 on Their Investments and Operations

With the S&P 500 and the Dow 30 indices surging and trading close to their record highs ⁷ in the days following the projection that the former US Vice President Joseph R. Biden had been elected the 46th US president and the public announcement that a COVID-19 vaccine had proven to be 90% effective in late-stage trials, it is easy to forget that exactly eight months earlier, the stock market seemed to be in "free-fall" as we witnessed the stock market crash of 2020. On March 9, 2020, the Dow fell a record 2,013.76 points to 23,851.02. Only days later, on March 12 and March 16, the Dow experienced two more record-setting point drops.

In the immediate wake of the gut-wrenching market declines that occurred in March 2020, the valuations of some companies, particularly those in sectors where businesses were forced to temporarily suspend or dramatically reduce operations and were not easily adaptable to social-distancing mandates and concerns, shrank by more than 80% from their 52-week highs. As such, many activist investors had their hands full in dealing with their existing positions, some of which were then significantly underwater.

Lack of Historical Precedent of Activist Investors Waging Campaigns in the Wake of a Global Pandemic and Related Global Economic Shutdown

Even among the most experienced activist investors, none could claim any experience waging an activism campaign in the wake of a global pandemic of the scale of COVID-19 and the related global economic shutdown.

Activist Investors Faced Challenges in Coordinating Their Engagement With the Company's Board and Management Team

In recent years, many activist investors have been very successful in being able to constructively engage with company boards and management teams, at times outside of public view, and

⁷ On November 9, 2020, the first trading day after former US Vice President Joseph R. Biden was projected to have been elected the 46th US president, the S&P 500 closed at 3,550.50 and the Dow 30 closed at 29,157.97. The record closing high for the S&P 500 is 3389.78 set on August 18, 2020 and the record closing high for the Dow 30 is 29,551.42 set on Feb. 12, 2020.

communicate a convincing argument as to why their ideas make sense for the company and would lead to enhanced shareholder value. In some cases, such constructive engagement has led to some activism campaigns ending before they even got publicly announced or, even if they got publicly announced, ending well in advance of a shareholder vote. To that end, as part of a company's activism preparedness plan, companies are often advised to plan for that engagement and identify in advance who would be the most effective company representatives, and coached on how to make those engagements as constructive and productive as possible.

During the 2020 proxy season, activist investors had to confront the possibility that it would likely be more challenging to engage with boards and/or management teams when much of the world was not only working from home, but also was still in the early stages of finding their "sea-legs" in the evolving work from home environment. More problematic for such engagements was that boards and management teams had their hands full focusing on the health and safety of their employees, staying afloat, preserving and ensuring access to liquidity, discerning how best to pivot the company's business model, preserving the overall health of the business, and ensuring the company's ability to rebound from the COVID-19 pandemic.

Activist Investors Faced Challenges in Engaging with Investors

Activist investors also had to contend with the logistical challenges of engaging with investors in a virtual meeting environment. Typically, activist investors would make the rounds with a company's institutional investors to build support for their ideas and campaign and, at some point, after a proxy statement was filed with the SEC, solicit a proxy card. All of that would now need to be accomplished in a socially-distant manner, which meant holding such meetings virtually. After more than eight months of participating in multiple virtual meetings every business day, many of us may forget how alien the concept of virtual meetings was at the beginning of the COVID-19 pandemic.

Activist Investors Faced Challenges in Pursuing a Proxy Contest at a Virtual Shareholders Meeting

During the 2020 proxy season, more companies held a virtual shareholders' meetings than ever before. It is likely that this trend will continue and it also likely that the infrastructure for virtual meetings will continue to improve as we look towards the 2021 proxy season. While virtual shareholders' meetings and waging a proxy contest at a virtual shareholders' meeting may become the new "normal," prior to the 2020 proxy season, virtual meetings were still an evolving practice and there was not much historical precedent for proxy contests at virtual meetings prior to the 2020 proxy season.

Possibility that Activist Investors Would Have Been Perceived as 'Tone-Deaf' to the Pandemic and What Companies Were Dealing With If They Waged a Campaign

There was also the possibility that activist investors would have looked "tone-deaf" waging campaigns against companies already facing unprecedented challenges due to the COVID-19 pandemic and related global economic shutdown. Clearly, in the early months of the COVID-19 pandemic, the optics were not favorable for an activist investor to criticize a company's performance and suggest shareholder value enhancement options when, in some cases, the

company's ability to stay afloat long enough to persevere through the pandemic and rebound was in question.

Activist Investors Had Limited Ability to Credibly Criticize Company Performance and Management's Response to COVID-19

While not impossible, activist investors would have also found it difficult to criticize company performance when the playing field and global macroeconomic environment had so radically and unexpectedly shifted in a way that no company could ever have anticipated and planned for. It would also be difficult for any activist investor to attempt to credibly argue that it had a better plan for managing through the COVID-19 pandemic than the company's incumbent board and management.

Activist Investors Had Limited Ability to Articulate a Credible Strategy for Enhancing Shareholder Value in the Immediate Aftermath Of COVID-19 as Various Popular Value Enhancement Options Fell Out of Favor

Activist investors typically have an investment thesis that they believe shows the potential for unlocking value at a particular company. To that end, the activist investor identifies a lever to unlock shareholder value that they believe, through engagement with a company's board and/or management or a public campaign, is accessible in the near-term. While clearly activist investors learned a great deal during the 2020 proxy season, prior thereto, there was absolutely no playbook for executing an activist investor-driven investment thesis in the wake of a global pandemic like COVID-19 and a related global economic shutdown.

As companies struggled to stay afloat and preserve their ability to rebound from the COVID-19 pandemic, many of the strategies activist investors typically use to enhance shareholder value at their targets, such as unlocking the sum-of-the-parts value of company operations via asset sales or spinoffs, or seeking to monetize non-core assets may have been difficult for activist investors to credibly present as something that companies, rather than focusing on their response to the pandemic, should turn their attention to.

During the 2020 proxy season, activist investors may have also found it difficult to push some of the more popular activist investor-driven initiatives such as stock buybacks or special cash dividends. While returning cash back to stockholders through stock buybacks and/or special cash dividends may be coming back into vogue, they were not particularly fashionable during the 2020 proxy season. For companies that benefited from the US government's \$2.3 trillion economic stimulus package, companies were prohibited from engaging in stock buybacks through September 2020.

Possibility that Activist Investor-Driven Board Changes Would Not Have Been as Attractive to Investors as They Would Be in the Absence of the COVID-19 Pandemic

One of the most frequent demands by activist investors is for companies to refresh their boards. The possibility that an activist investor would have the support of investors for board refreshment provides the activist investor with a significant amount of leverage to place pressure on the company's board and/or management team to engage with the activist investor and consider its ideas for enhancing shareholder value.

During the 2020 proxy season, activist investors had to consider whether investors would be as supportive of replacing directors in the immediate wake of the COVID-19 pandemic as they otherwise would have been. At a time when companies had significant need for continuity, institutional memory, and experience to help them navigate through an unprecedented crisis, activist investors had to consider that board refreshment may not have been very appealing to some investors.

How COVID-19 Could be a Catalyst for Shareholder Activism During the 2021 Proxy Season

Notwithstanding that the COVID-19 pandemic was clearly a limiting force on shareholder activism during the 2020 proxy season, as we look toward the 2021 proxy season, there are numerous reasons to believe that the COVID-19 pandemic could be a catalyst, in numerous ways, for driving shareholder activism, including the following:

- Plethora of companies, particularly small-caps, with stock prices that have not recovered from the March 2020 COVID-19-driven market crash in the way that many large-caps have recovered
- COVID-19 provides activist investors with an opportunity to drive a narrative for why activist-driven change is needed at a company
- COVID-19 has revealed new paths for shareholder value enhancement in the “new normal”
- Opportunity for activist investors to pressure weakened companies to sell to stronger players and M&A activity is likely to be bolstered by the surge in SPACS/blank-check companies
- Activist investors may position themselves as “white knights” uniquely suited to rescue the company
- Activist investors may believe that companies will settle to avoid the distraction and expense of a proxy contest

Plethora of Companies, Particularly Small-Caps, With Stock Prices that Have Not Recovered from the March 2020 COVID-19 Driven Market Crash in the Way that Many Large-Caps Have Recovered

While activist investors have shown an increased preference for large-cap companies in 2020, both globally and in the United States and while large-cap activism situations tend to get more media attention than small-cap activism situations, more than half of the companies targeted in recent years, both globally and in the United States, are companies with market capitalizations below \$2 billion.⁸

While both the Dow 30 and S&P 500 indices surged forward following the projection that Joseph R. Biden had been elected the 46th US president and the announcement that a COVID-19 vaccine had proven to be 90% effective in late-stage trials, small-caps still lag significantly behind large-caps. As of November 12, 2020, the Russell 2000 is only up 3.45% year-to-date, while the S&P 500 is up 10.11%. As such, particularly with respect to the universe of small-cap companies,

⁸ Activist investor Insight

it is likely that, from a valuation perspective, activist investors will find no shortage of companies that may be attractively priced.

COVID-19 Provides Activist Investors With an Opportunity to Drive a Narrative for Why Change Is Needed

COVID-19 provides activist investors with an opportunity to drive a narrative that illustrates their pre-pandemic concerns with companies they target. Even if the COVID-19 pandemic and government-mandated business closures that followed in response thereto have resulted in an unprecedented crisis of such an epic scope that would have been impossible for any company to anticipate and plan for, some activist investors may believe that the company's performance during COVID-19 provides ample proof points supporting their case for change. Activist investors may attempt to drive the narrative that, given the company's performance since the onset of the COVID-19 pandemic, particularly when compared to industry peers, the company needs to enhance the composition of its board of directors and its leadership if it is going to have any chance of rebounding from the COVID-19 pandemic. In the wake of COVID-19, an activist investor seeking to build a narrative of why activist investor-driven change is needed at a company may look to highlight the following:

- Lack of a strong, crisis-ready, and resilient board of directors and management team
- Missing functional competencies among the company's board of directors and management team
- Failure of the company to successfully and quickly pivot its business model and strategy in response to the challenges posed by the COVID-19 pandemic, particularly when compared to industry peers
- Flaws in a company's strategic plan and business model, particularly in light of the pandemic-driven shifts towards digitally-centered contactless commerce
- Failure of the company to reduce its cost structure in the wake of COVID-19 driven changes (e.g., less than optimal real estate footprint in a work from home and digital commerce centered environment)
- Failure of the company to manage its supply chain to address quick-moving shifts in customer demand and reduce dependency on particular geographic regions
- Failure of the company to thoughtfully and responsibly manage and address liquidity issues caused by the COVID-19 pandemic
- Failure of the company to develop and publicly articulate a strategy on how the company will be able to persevere through the pandemic and rebound
- Failure of the company to develop and publicly articulate a strategy for successfully restarting once government mandates on business closures and social distancing began to be loosened
- Failure of the company to develop and publicly articulate a credible strategy for enhancing shareholder value in the wake of the COVID-19 pandemic
- Disconnects between executive compensation and the company's share price performance highlighted by the COVID-19 pandemic
- Failure of the company to develop and implement policies and protocols that ensure the health and safety of the company's human capital while enabling the company to function effectively and service its customers

COVID-19 Has Revealed New Paths for Shareholder Value Enhancement in the ‘New Normal’

Since the onset of the COVID-19 pandemic, companies have had to pivot their business models and reimagine their businesses in ways that allow them to service their customers in the “new normal” and take into account a new paradigm of work from home, virtual schooling, home as the epicenter of daily life, accelerated shifts to ecommerce and touchless transactions, government-imposed social distancing, and wariness for public spaces and crowds, particularly indoors.

As companies become more creative in reimaging their businesses and developing new ways of conducting business that provide alternative revenue streams, they also highlight for activist investors new paths for shareholder value enhancement that other companies may not be pursuing. The hospitality industry provides an obvious and relevant example, given how much interest activist investors have shown in targeting hospitality companies in recent years. When government mandates shuttered restaurant dining rooms across the country at the onset of the pandemic, restaurants were forced to pivot to make up for the loss of revenue from in-restaurant dining. Many restaurants, to the extent their business lent itself to carry-out, pivoted to online orders, home delivery, takeout, and curbside pickup.

Other restaurants, particularly those with larger kitchens and with menus not as easily adaptable to takeout and/or delivery, developed “ghost kitchens” where, effectively, a fast-casual restaurant was “secreted” in the kitchen of a sit-down casual dining restaurant. In some cases, the menu offerings for the “ghost kitchen” have no obvious nexus to the menu of the restaurant in which it is housed. In complete 20/20 hindsight, you can imagine more than a few hospitality company executives wondering why they had not attempted to develop this alternative revenue stream pre-pandemic. In any case, this is an example of a new shareholder value enhancement path that was not as obvious pre-pandemic as it is today. For an activist investor targeting a publicly-traded hospitality company, such as a casual dining chain, “ghost kitchens” and the additional revenue that can be derived therefrom are just one path for shareholder value enhancement brought into sharper focus by the COVID-19 pandemic.

The retail industry is another industry where the pandemic has highlighted for activist investors new paths for shareholder value enhancement. The COVID-19 pandemic has bolstered the case for retailers to develop and/or enhance their omni-channel capabilities, including ecommerce, curbside pickup, and same-day delivery. In the wake of the COVID-19 pandemic, an activist investor may demand that a retailer adopt and implement additional e-commerce and omni-channel capabilities and adopt a better strategy for driving a higher percentage of revenue from channels not dependent on consumers entering and/or making their buying decisions at physical stores. As more retailers enhance their ecommerce and other omni-channel capabilities in recognition of the accelerated shift away from physical stores to digital shopping, as well as consumers’ wariness for crowds and indoor public spaces, an activist investor may also demand that a retailer optimize its physical store footprint. Such a demand can take a number of forms, including a reduction in total physical stores, the closure of lesser-performing physical stores, a reduction in the square footage of various physical stores, a renegotiation of lease payment terms, and/or the relocation of physical stores. Again, there are paths for shareholder value enhancement brought into sharper focus by the COVID-19 pandemic.

Opportunity for Activist Investors to Pressure Weakened Companies to Sell to Stronger Players and M&A Activity Is Likely to Be Bolstered by the Surge in SPACS/Blank-Check Companies

Companies that have had their market valuations significantly reduced, or that have market valuations that lag behind their larger peers, may be perceived as compelling targets for strategic and financial buyers, even if long-term shareholders may resist M&A transactions with prices that leave them significantly underwater.

Some activist investors may believe that, given the substantial impact that the COVID-19 pandemic has had on many industries, there is now a unique opportunity to push for the weaker companies in those industries, particularly those with liquidity challenges, to combine with the stronger companies.

It is also likely that the recent proliferation of SPACS, including those formed by activist investors, will only further fuel activist investors' demands for M&A. Even if the SPAC is not looking to merge with or acquire an already public company, where an activist investor is demanding that a public company pursue some form of "carve-out" or spin-off transaction, the availability of numerous SPACS to participate in those transactions can be expected to be a catalyst for those types of activist investor demands.

Activist Investors May Position Themselves as 'White Knights' Uniquely Suited to Rescue the Company

Some activist investors may attempt to portray themselves as "white knights" seeking to be helpful to the company in its time of need and offering to help the company overcome the crisis. Some activist investors, particularly those that see themselves as more constructivist in nature, may believe that their skillsets and experience at other companies, including those in the same industry, make them uniquely suited to help companies navigate through and emerge from the COVID-19 pandemic. In some cases, companies may welcome that assistance, particularly if the company needs additional liquidity and the activist investor can make such liquidity available. This "selling point" may be very appealing to institutional investors familiar with a particular activist investor, its experience in a particular industry, and its track record in helping to drive turnarounds

Activist Investors May Believe that COVID-19 Will Cause Companies to Settle With Them

In any given year, only a small percentage of proxy contests are decided by a shareholder vote as many companies make concessions that result in the activist investors agreeing to withdraw their campaigns.⁹

In 2020, there were only 16 contested shareholders' meetings that resulted in activist investors gaining board seats, compared with 80 settlements with the activist investors that resulted in activist investors gaining board seats.¹⁰ Out of the 168 directors placed on company boards by activist investors, 135 were placed on boards pursuant to settlement agreements with the activist

⁹ FactSet Research, Inc.

¹⁰ Activist investor Insight (as of September 30, 2020)

investors and only 33 were placed on boards via a shareholder vote.¹¹ Activist investors may believe that, given that many companies remain focused on staying afloat, addressing their liquidity needs, the overall health of their business, and their ability to persevere through, and rebound from, the COVID-19 pandemic, they may be more likely to settle with the activist investor to avoid a proxy contest and its related costs and disruption.

Other Forces That Could Drive Shareholder Activism During the 2021 Proxy Season

In addition to the COVID-19 pandemic, there are other forces at play that will also likely drive shareholder activism during the 2021 proxy season, including the following:

- Activist investors don't get paid to "sit on the sidelines" and there is likely pent-up demand by activist investors who held back during the 2020 proxy season
- Relative to other investment opportunities, shareholder activism remains very attractive for investors seeking yield
- Activist investors will continue to benefit from a highly conducive regulatory environment
- Value enhancement initiatives like stock buybacks and special cash dividends will again be in vogue
- Evolving acceptance of the "new normal" and increased comfort in conducting an activism campaign in a socially-distant environment
- Enhanced infrastructure for conducting proxy contests at virtual shareholders' meetings
- COVID-19 has caused companies to be less prepared to engage with and respond to activist investors

Activist Investors Don't Get Paid to Sit on the Sidelines

As noted above, as of the third quarter ended September 30, 2020, activism activity was clearly down in 2020 when compared to the same period in 2019.¹²

Regardless of whether activist investors are able to correctly identify targets with substantial potential upside and regardless of whether the traditional activist investor playbook is workable in the current environment, it is important to note that activist investors get paid fees to develop and implement activist investor strategies, not sit on the sidelines.

Activist investors may be reluctant to have to explain why they are not putting their clients' money to use and have to answer the question, "If not now, when?" Activist investors, concerned with preserving their credibility as an activist investor, may also be reluctant to be accused of missing out on investment opportunities, particularly if their competitors are willing to take positions.

Relative to Other Investment Opportunities, Shareholder Activism Remains Very Attractive for Investors Seeking Yield

¹¹ Activist investor Insight (as of September 30, 2020)

¹² Activist investor Insight (as of September 30, 2020).

With the US Federal Reserve's current and very accommodative monetary policy of keeping interest rates near zero until the economy is able to overcome the effects of COVID-19, relative to other investment opportunities, it remains very attractive for institutional investors to allocate a portion of their funds to investment vehicles with an activist investor strategy. It has often been said that activism, particularly large-cap activism, would never have acquired the momentum it has without the support of institutional investors. The expectation that the Federal Reserve is likely to maintain an extremely low interest rate environment can only be expected to further institutional investors' continued willingness to commit funds to investment vehicles with an activist investor strategy.

Activist Investors Will Continue to Benefit from a Highly Conducive Regulatory Environment

Shareholder activism has always benefitted from a highly conducive regulatory environment. Notwithstanding the change in administrations that will occur in January 2021 when President-elect Biden takes office and the shift from a Republican Party-led executive branch to a Democratic Party-led executive branch, it is not likely that we will see any change in the regulatory environment that will significantly impact shareholder activism in the 2021 proxy season. Even past the 2021 proxy season, and taking into effect that we will likely have different parties controlling the White House and the US Senate, it remains unclear, particularly given other legislative and regulatory priorities such as those that address the impact of COVID-19, that any material change in the laws, regulations, and rules that impact shareholder activism will likely gain any traction over the next 12–18 months.

Value Enhancement Initiatives Like Stock Buybacks and Special Cash Dividends Will Again Be in Vogue

During the 2020 proxy season, it was difficult for activist investors to push some of the more popular activist investor-driven initiatives such as stock buybacks or special cash dividends. With the ultimate duration and impact of the COVID-19 pandemic extremely uncertain, and with much of the United States and the world in a state of lockdown for most of the spring, companies and investors alike were very focused on preserving and shoring up access to liquidity. The idea of returning what some may otherwise perceive as excess cash, and others regard as “rainy-day” funds, quickly became unfashionable. Many companies were concerned that even those “rainy-day” funds would not be sufficient to get them through what would more aptly be described as at least a “tropical cyclone.” In addition, the \$2.3 trillion economic stimulus package that US President Donald J. Trump signed into law on March 27, 2020, the largest federal stimulus package in US history, contained a provision that prohibited companies that tapped into the fund to engage in stock buybacks through the end of September 2020.

As we look towards the 2021 proxy season, with the initial shock of the COVID-19 pandemic behind and companies having improved visibility on their liquidity needs, it is likely that activist investor demands like stock buyback and cash dividends will again be back in fashion, particularly at companies that have been able to weather the COVID-19 pandemic without much need to tap into their cash reserves.

It is also possible that, as the Federal Reserve maintains interest rates near zero, that activist investor will look for companies to reassess their capital structure and consider borrowing more to fund stock buyback and special cash dividends.

Evolving Acceptance of the ‘New Normal’ and Increased Comfort in Conducting an Activism Campaign in a Socially-Distant Environment

As discussed above, during the 2020 proxy season, activist investors were presented with numerous logistical and practical challenges in waging an activist investor campaign, including the following: (i) challenges engaging virtually with company boards and management team, (ii) challenges engaging virtually with investors, and (iii) challenges conducting a proxy contest at a virtual shareholders’ meeting. In complete 20/20 hindsight some eight months later, those challenges look much less daunting. It is not hard to imagine that over the past eight months, there have been hundreds of meetings between company representatives and activist investors conducted over Microsoft Teams, Webex, Zoom, and/or other similar virtual meeting platforms and all parties have now acquired their “sea-legs” for conducting such meetings.

Enhanced Infrastructure for Conducting Proxy Contests at Virtual Shareholders’ Meetings

During the 2020 proxy season, the experience of many companies and activist investors with virtual shareholders’ meetings was very limited. While the infrastructure for conducting such meetings existed, it was still evolving and there was limited capacity to accommodate all the companies that wanted to hold a virtual meeting for the first time in their history. In addition, there was little precedent for conducting a proxy contest at a virtual shareholders’ meeting and numerous logistical questions abounded as to how certain mechanics would be handled. As we look toward the 2021 proxy season, those challenges look much less daunting and the infrastructure for virtual meetings, whether uncontested or contested, appears to be firmly in place and will likely continue to evolve between now and the 2021 proxy season.

COVID-19 Has Caused Companies to be Less Prepared to Engage With and Respond to Activist Investors

If many companies were “sitting ducks” prior to the COVID-19 pandemic and were reluctant to acknowledge how vulnerable they were to an activist investor and how unprepared they were would an activist investor seek to engage with them, the pandemic, while unprecedented and impossible for companies to anticipate, has likely only exacerbated such vulnerabilities.

Given that the primary focus of many companies over the past eight months has been on preserving liquidity, staying afloat, pivoting the company’s business model to respond to changes wrought by the COVID-19 pandemic, and the overall health of their businesses, it is likely that preparing for shareholder activism and developing “break-glass” plans for how to respond to an activist investor were not high on the priority lists of many companies.

How a Company Could be Vulnerable to An Activist Investor in the Wake of COVID-19

An activist investor does not target a company just because the company is vulnerable. As noted above, an activist investor must first determine (i) that there is an opportunity to generate an outsized return because the company is undervalued by the financial markets relative to its

intrinsic value or potential for growth or value enhancement, and (ii) that there is a lever the activist investor can access that will unlock shareholder value. If a company meets those two criteria, it may be an attractive target for an activist investor. Thereafter, the activist investor needs to determine how vulnerable the company is to an activist investor seeking to be a catalyst for change.

Many companies were already vulnerable to activist investors pre-pandemic due to the following:

- Poor stock price, operating, and/or financial performance, particularly compared to peers
- Perceived inability to create shareholder value without meaningful change
- Missteps by the company's management team and the perception that the company's management team is unable to execute
- The management team's inability to articulate a strategy on how the company will drive shareholder value creation
- Executive compensation not sufficiently aligned with performance
- Lack of attention to environmental, social, and governance (ESG) issues
- Lack of confidence by investors in the company's board of directors and/or management team

COVID-19 has not only exacerbated pre-pandemic vulnerabilities for some companies, but it also provides activist investors with an opportunity to illustrate their pre-pandemic concerns with those companies. In the wake of COVID-19, an activist investor seeking to build a narrative of why activist investor-driven change is needed at a company may look to highlight the following vulnerabilities:

- Lack of a strong, crisis-ready, resilient board of directors and management team
- Voids in functional competencies among the board/management that have been revealed by the COVID-19 pandemic
- Missteps by the company in how it responded to the COVID-19 pandemic
- Flaws in a company's strategic plan and business model, particularly in light of the pandemic-driven shifts towards digitally-centered contactless commerce
- Failure of the company to successfully and quickly pivot its business model and strategy in response to the challenges posed by the COVID-19 pandemic, particularly when compared to industry peers
- Failure of the company to reduce its cost structure in the wake of COVID-19 driven changes (e.g., less than optimal real estate footprint in a work-from-home and digital commerce centered environment)
- Failure of the company to manage its supply chain to address quick-moving shifts in customer demand and reduce dependency on particular geographic regions
- Failure of the company to thoughtfully and responsibly address liquidity issues caused by the COVID-19 pandemic
- Failure of the company to develop and publicly articulate a strategy for successfully restarting once government mandates on business closures and social distancing began to be loosened
- Failure of the company to develop and publicly articulate a strategy on how the company will persevere through the COVID-19 pandemic and rebound

- Failure of the company to develop and publicly articulate a credible strategy for enhancing shareholder value in the wake of the COVID-19 pandemic
- Failure of the company to develop and implement policies and protocols that ensure the health and safety of the company's human capital while enabling the company to function effectively and service its customers
- Disconnects between executive compensation and the company's share price performance highlighted by the COVID-19 pandemic

In addition, as noted above, the COVID-19 pandemic has caused many companies to become more creative in reimagining their businesses and developing new ways of conducting business and alternative revenue streams in the "new normal." However, these innovative and resourceful companies have also highlighted for activist investors new and novel paths for shareholder value enhancement that other companies have not pursued. There may be rational explanations why some of these pivot strategies cannot be applied universally, but the onus will be on the company to pre-emptively communicate clearly to its investors, like with most untaken paths for shareholder value enhancement, why some of these pivot strategies are not practical for the company to pursue. In the absence of such a pre-emptive explanation, we should expect an activist investor to raise a company's failure to pursue one of these pivot strategies as a criticism and include it within its narrative of why activist investor-driven change is needed at a particular company.

What to Expect from Activist Investors During the 2021 Proxy Season

While the US presidential vote remains to be certified, President-elect Biden will be inaugurated on January 20, 2021 as the 46th US president and, thereafter, we will have a new administration in office overseeing the executive branch of the US government. At the same time, the COVID-19 pandemic continues to cause turmoil as it surges across the United States. As the United States surpasses 11 million COVID-19 cases and approaches 250,000 deaths caused by COVID-19 and numerous states set daily records for new cases and hospitalizations, there are news reports that some states and/or locales may revert to some version of the restrictions that were put in place last March to stem the spread of the COVID-19 virus and "flatten the curve." Already, we have seen the United Kingdom (UK) institute a second national lockdown that will continue at least until the end of November after the UK passed the milestone of one million coronavirus cases. We also have the recent news that two COVID-19 vaccines have proven to be effective in late-stage trials and may be widely available by the spring of 2021. Even if effective COVID-19 vaccines are able to be made widely available by then, it remains unclear when we will be on path to some semblance of normality and whether that will be before 2022.

It is important to note that, in the context of the uncertainty and turmoil discussed above, many activist investors have already selected the companies they plan to target during the 2021 proxy season and have already familiarized themselves with the requisite deadlines for submitting to such companies an advance notice of nominations and/or shareholder proposal. Activist investors may still be in the process of recruiting nominees for possible slates, but unless a company has a particularly early advance notice deadline, activist investors still have plenty of time to complete that process. The larger point is that between now and the end of the year, activist investors will have a fairly clear idea of the companies they plan to target during the 2021 proxy season. However, how current events between now and then impact an activist investor's plans remains uncertain. As noted above, because COVID-19 was declared a pandemic in March 2020, well

after most activists would have selected their targets for the 2020 proxy season, the overall impact of COVID-19 on shareholder activism was lessened. Notably, unlike with respect to the 2020 proxy season, activist investors currently planning for the 2021 proxy season are making those plans aware of the existence of the COVID-19 pandemic and its implications and having to anticipate and incorporate into their plans the possibility that, even if the current case surge is reversed and further extended lockdowns are avoided, the COVID-19 pandemic is not likely to materially subside between now and the end of the 2021 proxy season.

Mindful of the above context, this is what we would expect to see from activist investors during the 2021 proxy season.

- Activist investors won't sit on the sidelines
- Activist investors will adapt to the "new normal" and will become very comfortable in conducting an activism campaign in a socially-distant environment
- COVID-19 is not likely to have the restraining impact on shareholder activism it did in 2020
- Activist investors will continue to benefit from a highly conducive regulatory environment
- Activist investors will be cautious and selective in choosing and engaging with targets
- Activist investors may seek to retain more optionality on whether to pursue a campaign such that they are better positioned to abandon their campaign if external events impede their investment thesis or the feasibility of a campaign
- To preserve optionality, activist investors will seek to engage with companies behind the scenes and in a less public manner which is easier to accomplish with large-cap targets since the filing of a Schedule 13D may not be required
- Large-caps will continue to represent a larger percentage of the companies targeted by activist investors
- Small-caps will likely continue to represent well in excess of a majority of the companies targeted by activist investors
- Activist investors may avoid sectors not adaptable to conducting business in a contactless environment
- Activist investors will drive narratives around company performance in response to the COVID-19 pandemic, particularly in comparison to peer companies in their industry, and whether the company has a sufficiently resilient board and management team capable of pivoting in times of crisis
- Activist narratives making the case for activist-driven change are likely to include more arguments focused on the company's handling of ESG issues, particularly environmental and social issues such as climate change and racial equality
- Related to being in a position to credibly highlight how the company has handled ESG issues, activist investors will be under more pressure to propose diverse slates of director nominees, particularly if the board changes they are pushing for would otherwise reduce a board's diversity
- Activist investors will present demands for value enhancement that would not have been presented in the absence of COVID-19
- M&A (whether sale of the company or sale or spin-off of a business) will likely be the dominant demand by activist investors
- Value enhancement initiatives like stock buybacks and cash dividends will again be in vogue

- Possibility for SPACS to drive some M&A demands, particularly spin-off and “carve-out” demands
- Virtual shareholders’ meetings, whether contested or uncontested, will be the prevailing practice for most public companies which will also have the added benefit of enhancing retail investor voting turnout and participation

Steps to Avoid Being a ‘Sitting Duck’ for An Activist Investor During the 2021 Proxy Season

While the COVID-19 pandemic was certainly a limiting force during the 2020 proxy season, we would not expect that to be the case during the 2021 proxy season even as the COVID-19 pandemic shows no signs of abating in the near-term. Activist investors have now had eight months to acquire their “sea legs” and recalibrate their playbook for the evolving “new normal” and, unless the environment changes in a way not currently anticipated, it is likely that many activist investors will not be hesitant to wage an activism campaign in whatever “new normal” we find ourselves in during the 2021 proxy season.

A company’s experience in traversing through, and pivoting its business in response to, the COVID-19 pandemic, had made many companies more vulnerable to activist investors by providing case studies that illustrate an activist investor’s case for why change is needed at a company.

Further, COVID-19 has revealed new paths for companies to enhance shareholder value as companies reimaged their business models, pivoted in response to the COVID-19 pandemic, enhanced their omni-channel capabilities, and developed new revenue streams, many centered on a new economy approach. Many of these paths to enhance shareholder value existed pre-pandemic, but were not in as sharp focus as they are now. Companies that were not as successful in pivoting their business models as other in their industry have done should expect that they will be criticized.

While activist investors tend to center their campaigns on economic issues and not ESG issues, given how much environment and social issues have moved to the forefront of the national discourse this year, companies should expect activist investors will use these issues to help them drive their narrative for why the company is in need of activist-driven change.

It is also likely that the recent proliferation of SPACS, particularly SPACS formed by well-known activist investors, may be a strong catalyst for increased shareholder activism during the 2021 proxy season, particularly where an activist investor is demanding that a company pursue some form of carve-out or spin-off transaction to unlock shareholder value.

While the primary focus of many companies in the near term will likely be on continuing to persevere through the COVID-19 pandemic and address the challenges created by the pandemic, companies should also anticipate that activist investors, in addition to identifying opportunities that have little nexus to the COVID-19 pandemic, will see some of the disruption and turmoil caused by the COVID-19 pandemic as having also created opportunities where they can drive change and unlock shareholder value.

Accordingly, companies looking to prepare themselves for the possibility that they will be targeted by one or more activist investors during the 2021 proxy season should consider taking the following actions:

- Assemble an activism response team (e.g., counsel, financial advisor, PR, proxy solicitor)
- Enhance processes to receive early warning of an activist investor targeting the company
- Enhance processes to receive early warning of an activist investor targeting the company (e.g., stock watch, SEC filings on Form 13F, Schedule 13G, and Schedule 13D, activist investors attending earnings calls, market rumors, media inquiries)
- Review and analyze the company's shareholder profile on a regular basis
- Identify any activist investors that could be potentially interested in targeting the company
- Monitor activist campaigns against industry peers
- Conduct a comprehensive assessment of the company's vulnerabilities to an activist investor
- Consider enhancing structural defenses, taking into consideration the voting guidelines of the proxy advisory firms and institutional investors
- Consider the need for a "poison pill," either one intended to protect against an unsolicited acquisition of control of the company or to protect the company's net operating loss carryforwards (NOLs) from being limited pursuant to Section 382 of the Internal Revenue Code
- Even if it is determined that a "poison pill" is not currently needed, consider having a "shelf" poison pill prepared, reviewed with the company's board, and ready to be adopted
- Develop and maintain a timetable of key corporate events and deadlines, including for the receipt of advance notices of nominations and shareholder proposals as well as the latest date by which the company needs to hold its annual meeting in accordance with its governing documents and/or state law
- Become intimately familiar with any paths available to unlock shareholder value and be prepared to explain why any of those paths may not be appropriate to consider pursuing
- Be prepared to explain why a sale of the company now would not maximize shareholder value
- Determine whether there are any gaps in critical experiences and competencies on the company's board, particularly in light of the challenges posed by the COVID-19 pandemic
- Anticipate how an activist investor would criticize the company, including its response to the COVID-19 pandemic and its performance in pivoting its business model in light of the challenges posed by the pandemic
- Refine strategic communications to hone key messages on how the company is being impacted by the COVID-19 pandemic and what steps the company is taking to stay afloat, address its liquidity needs, pivot its business, maintain the overall health of its business, and ensure its ability to rebound from the crisis
- Develop a "break-glass" plan for responding to an activist investor targeting the company
- Plan today for how the company would engage with an activist investor targeting the company
- Proactively address market rumors that question the company's ability to survive the COVID-19 pandemic
- Plan investor outreach to assess investor sentiment, gather intelligence, and gain input on the company's current strategy for responding to the COVID-19 pandemic and enhancing shareholder value



Activism In Context: Where We've Been, Where We're Going

Posted by Arthur B. Crozier and Gabrielle Wolf, Innisfree M&A, Inc., on Monday, February 22, 2021

Editor's note: Arthur B. Crozier is Chairman and Gabrielle Wolf is a Director at Innisfree M&A, Inc. This post is based on their Innisfree memorandum. Related research from the Program on Corporate Governance includes [The Long-Term Effects of Hedge Fund Activism](#) by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum [here](#)); [Dancing with Activists](#) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum [here](#)); 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. (discussed on the Forum [here](#)).

Activism In Context: Where We've Been, Where We're Going¹

Depressed Activism in H1 2020 Comes Rearing Back in Q4

COVID depressed activism campaigns in H1 of 2020 to the lowest level since 2014, as many activists recognized that proxy contests would distract issuers from focusing on the urgent task of adapting their businesses to a volatile market and changing world. Activists were also surely wary of appearing to take advantage of unanticipated market dislocation, due to concerns that such efforts would not be favorably viewed by institutional investors in particular, whose votes are crucial to winning proxy contests. That said, as the pandemic and resulting lockdown lasted longer than first anticipated and businesses successfully adapted, activists arose from hibernation and launched 30 new campaigns in Q4 2020.² According to Lazard, the number of U.S.-based activist campaigns in Q4 2020 represented a 200% increase from Q3 2020 campaign numbers and 34% of all 2020 campaigns. Of particular interest, one-fifth of the dramatic Q4 uptick was focused on targets with a market capitalization of at least \$25B,³ including Comcast, Disney, Public Storage, Intel and ExxonMobil.

Despite its slowdown in 2020, several developments, particularly in the last half of 2020, are likely to continue and to define the state of activism in 2021.

¹ "I have great respect for the past. If you don't know where you've come from, you don't know where you're going". Maya Angelou

² Information from Lazard's 2020 Review of Shareholder Activism.

³ Information from Lazard's 2020 Review of Shareholder Activism.

Number of Dissident Directors Seated in 2020 Surpasses Prior Years, Control Slates on the Rise

Activist pressure resulted in the seating of 131 directors in 2020, notwithstanding the downturn in activism campaigns. While 82% of these new directors were seated through settlements, a level in line with prior years, the total number of dissident directors was boosted to the highest level since 2014 by Starboard's majority slate win at GCP Advanced Technologies (8 dissident directors elected to a 10-member Board) and Mack Cali's eleventh-hour settlement with Bow Street Capital placing 8 dissident directors on a 9-member Board. Xerox had also nominated a control slate as part of its attempted takeover of HP, but later withdrew its offer and its nominations. Starboard's recent nomination of eight candidates for Corteva's 12-member Board indicates that control slates are likely to be a more frequent tactic than in prior years.

M&A-Focused Campaigns Will Likely Continue To be Prime Activist Focus in 2021, But Underlying Theses May Change

M&A focused campaigns were down slightly in 2020, but still represented the most frequent activist target, although there were significant shifts in the frequency of the underlying theses, compared to prior years. Sell the company campaigns were 19% of all M&A activism campaigns in 2020, down from 34% in 2019, likely because H1 2020's volatile markets were inhospitable for M&A.⁴ Break-up/divestiture campaigns increased to 42% in 2020, compared to 33% in 2019.⁵ Bumpitriage, or activist campaigns to reject or improve announced deals, increased slightly from 32% in 2019 to 39% in 2020.

Activism in 2021, in turn, will be strongly affected by strength of equity markets, cash-saturated balance sheets, low interest rates and the resulting expected strong M&A rebound. Companies struggling with pandemic-related slips may face sell the company campaigns as a result, increasing the number of those campaigns compared to 2020. Similarly, we expect bumpitriage, or activist campaigns to reject or improve announced deals, to continue representing a substantial portion of M&A activism campaigns in 2021, especially as small cap companies with depressed stock prices are acquired on the cheap by peers whose stock prices rebounded following better crisis management.

PE firms will likely continue taking on activist roles⁶ or teaming with activists in pursuing M&A focused campaigns, such as Cannae's recent effort in tandem with Senator to force the sale of CoreLogic.

E&S Concerns Likely to Assume Greater Importance in Activist Campaigns

Developments in 2020 portend the growing primacy of E&S theses in activism campaigns. To the extent E&S concerns were featured in recent activism campaigns, they were typically woven into the activist's messaging as window dressing to draw support from index funds and were not

⁴ Information from Activist Insight database; Lazard's 2020 Review of Shareholder Activism.

⁵ Information from Activist Insight database; Lazard's 2020 Review of Shareholder Activism.

⁶ PE firms are also using activism tactics in non-M&A situations, e.g., KKR at Dave & Busters, New Mountain at Virtusa.

central to the activist’s platform. The common (mis)conception was that as economic animals, activists would only pay lip service to “fundamentally non-economic” E&S concerns. Investors, however, have come to recognize that E&S is *inherently* tied to long-term shareholder value. Indeed, two of the most popular E&S disclosure frameworks, TCFD and SASB, are formulated to help investors understand how an issuer’s E&S practices affect its financial condition and operating performance.

While E&S activism is in its nascent phase, it is primed to become a major driver of activism. As permanent shareholders who cannot “vote with their feet”, index funds already subscribe to the long-term focus that underlies E&S principles. The launch of new E&S activist funds, including Engine No. 1, Impactive Capital and Inclusive Capital Partners, is evidence that activists recognize the financially-material risks and opportunities related to sustainability dependencies. Engine No. 1’s nomination of four directors to the Board of ExxonMobil is premised on the argument that Exxon risks terminal decline if it continues to ignore the shift in consumer demands for cleaner energy. Traditional activist fund The Children’s Investment Fund (TCI) is working alongside As You Sow, the non-profit shareholder advocacy group focused on environmental and social corporate responsibility, to encourage 100 companies in the S&P 500 to adopt a “Say on Climate” proposal whereby shareholders are given the opportunity to vote on an issuer’s emission reduction plans.⁷ Union Pacific, Monster Beverage, Charter Communications and Alphabet received Rule 14a-8 proposals on the topic.⁸ Though it is unclear whether the three major index funds will support E&S activist slates in proxy contests, initial indications are positive.⁹ BlackRock, Vanguard and State Street are demanding more fulsome E&S disclosures from their portfolio companies; the E&S activist campaigns seek to improve underlying E&S behaviors at many of the same blue-chip issuers. Such enhanced disclosures could provide fodder for E&S focused activists.

That said, it remains to be seen whether issuers will skate by in 2021 by more clearly communicating their sustainability performance data or whether investors will truly push them to improve their sustainability performance, including by setting and executing on science-based carbon emissions reduction targets.

Laggards who Failed to Manage COVID Crisis are Likely Targets

The dramatic rise in activist campaigns in Q4 2020 and numerous nomination submissions in YTD 2021 indicate that activist activity will not subside in 2021. Companies that did not successfully adjust to the new and highly competitive COVID economy, effectively manage their remote workforce, digitize their business connectivity, and reposition their businesses to changing consumer behavior will be ripe targets.¹⁰ Activists have already taken aim at companies that lagged peers in adjusting their business models to the pandemic realities. Third Point targeted Disney by demonstrating that Disney+ did not take advantage of the increase in viewership

⁷ According to the Wall Street Journal, TCI is ready to launch proxy contests to force adoption of a “Say on Climate” vote if targeted companies do not voluntarily do so following engagement.

⁸ In response to pressure from TCI and As You Sow, Unilever, Royal Dutch Shell and Moody’s each announced it will implement a “Say on Climate” vote at its 2021 annual meeting and plans to seek advisory votes every one to three years on any changes to its net-zero plan.

⁹ Though very different than electing an activist nominee, BlackRock voted to support a “Say on Climate” proposal at Spanish airport operator Aena SA in 2020.

¹⁰ Indeed, a key element in Trian’s platform in its 2017 proxy contest at Procter & Gamble was the push to recognize consumer demands for sustainable products and packaging.

caused by the pandemic, especially as compared to Netflix. Similarly, Third Point pushed Intel to replace its CEO after criticizing Intel for, among other things, falling behind Advanced Micro Devices, which took advantage of the pandemic-related increase in online gambling. In general, 2021 activist campaigns will likely have a lessened hurdle to clear when soliciting for votes: in light of the impacts of COVID, it will be easier to demonstrate that change is warranted at companies that have lagged their peers. Instead, activists and incumbent Boards will have to convince institutional investors that their respective slate will oversee and successfully execute on the necessary transformations in the coming years.

Fasten your seatbelts. 2021 will be a wild ride.¹¹

¹¹ Cf. "Fasten your seatbelts. It's going to be a bumpy night". Margo Channing, *All About Eve*, (1950)



New Tactics and ESG Themes Change the Direction of Shareholder Activism

Posted by Richard J. Grossman and Neil P. Stronski, Skadden, Arps, Slate, Meagher & Flom LLP

Editor's note: Richard J. Grossman and Neil P. Stronski are partners at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum. Related research from the Program on Corporate Governance includes [The Long-Term Effects of Hedge Fund Activism](#) by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum [here](#)); [Dancing with Activists](#) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum [here](#)); [The Illusory Promise of Stakeholder Governance](#) by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum [here](#)).

Takeaways

- Activism is likely to rebound as the business world recovers from COVID-19 disruptions.
- Some activists are raising permanent capital, giving them new leverage, and activist approaches have become more acceptable to many institutional investors.
- Even high-performing companies may face pressure on ESG issues.
- The best defense is a solid relationship with and understanding of your shareholders, coupled with a plan for dealing with activists if they emerge.

Shareholder activism levels decreased in 2020 amid the upheaval and uncertainty brought on by COVID-19. But activists did launch a number of high-profile campaigns and there was an uptick of activism in the second half of the year; and more than 80 CEOs were replaced during activist campaigns.

Today, even well-performing companies may find themselves targets of activist campaigns on environmental and social issues, as new funds have been formed to specialize in these areas. Moreover, established activists have established new types of investment vehicles that could strengthen their hands. Preparing for the possibility of an activist campaign should therefore be on the board agenda at most public companies.

Expect an uptick in activism in 2021. Historically, many activist campaigns have focused on M&A and returns of capital. The economic uncertainty and liquidity issues companies faced in 2020 reduced M&A activity and made it harder for activists to advocate transformative deals, such as the sale of a company, a breakup or major divestiture, or a large dividend payout. In addition, there were fewer announced deals for activists to challenge.

As the economy rebounds and business becomes more predictable, activists are likely to press companies to undertake transactions and advocate for changes to the deals companies propose.

COVID-19 problems may spur some campaigns. Underperformance is another traditional target of activists. As businesses struggle to cope with the challenges of the pandemic, or if a company's stock price does not return to pre-pandemic levels, some could find themselves vulnerable to activists pressing for operational or governance changes.

Even companies with solid financial performance may face activists. Environmental, social and governance (ESG) themes featured prominently in 2020 activist campaigns, and several factors are likely to accelerate that trend.

Many institutional investors, even managers of passive index funds, have called for the business world to address environmental and social issues such as diversity. (See “**ESG: Many Demands, Few Clear Rules.**”) Major American and European oil companies, for instance, have been pressed to lower their emissions by activist groups that are backed by major pension funds and asset managers.

Some established activists have recently formed ESG-focused funds alongside their regular pools to target companies they contend have not met ESG standards, and some veteran activists, including ValueAct founder Jeff Ubben, have formed new ESG-only activist firms. Other new ESG funds have been formed by groups with few ties to established activist firms.

Boards need to prepare for this new set of players and their agendas, paying close attention to their companies' ESG profiles and ratings, and not just the financial vulnerabilities that traditionally attracted activists' attention.

The lines between activists and other investors are blurring. A number of major activist firms have begun acting more like private equity firms, pursuing outright acquisitions or negotiating for large stakes in companies for extended periods (private investments in public entities, or PIPEs). In 2020, three of the best-known names in activism, Pershing Square, Starboard Value and Third Point, formed SPACs (special purpose acquisition companies), shell companies that raised capital to buy businesses. One of the most influential established activist firms, Elliott Management, formed a buyout fund in 2019.

Meanwhile, some private equity firms have pursued more activist-like strategies, and in some cases, activists have teamed up with strategics or private equity firms on acquisitions. Since activists often zero in on management and operational shortcomings, a buyout is a logical next step.

These moves may alter the calculus for companies in some situations, because an activist investor with sufficient capital and a proven willingness to take a long-term position in a company or to take it private poses a more serious threat than one known only for saber-rattling and then trading out of the stock.

Traditional investors have become more open to activism. Over the last few years, as activism has become more accepted, some long-only asset managers, including money managers, have supported activist campaigns where they thought it would increase the value of their investments. Usually, this has been behind the scenes, but some traditional asset managers have now openly adopted activist tactics. For example, Wellington Management, the largest

shareholder of Bristol-Myers Squibb, came out against the drugmaker's \$74 billion deal to buy biotech Celgene in 2019.

This reflects a broader transition to a more shareholder-centric model of corporate governance. Potentially, any investor with a clear agenda, sufficient resources and the support of a wide shareholder base can utilize activist tactics.

Framing a Strategy

Given the evolution of activism, it is vital for boards to ensure that their companies have strategies to address activist pressure.

Shareholder engagement is the best defense. Ongoing dialogue with shareholders is the best preventive strategy. Know your most significant shareholders and understand their investment theses. Engagement with shareholders more broadly allows management to build relationships, articulate the company's strategy and establish the credibility that management and the board will need in the event an activist surfaces.

Executives usually take the lead in communications with shareholders, but direct engagement by independent directors is becoming more common, particularly regarding subjects under the board's purview, such as executive compensation, capital allocation and succession planning, and when a company is facing major challenges. A company needs to weigh the pros and cons of using a director in this role, and give careful thought to the choice of directors and prepare them thoroughly.

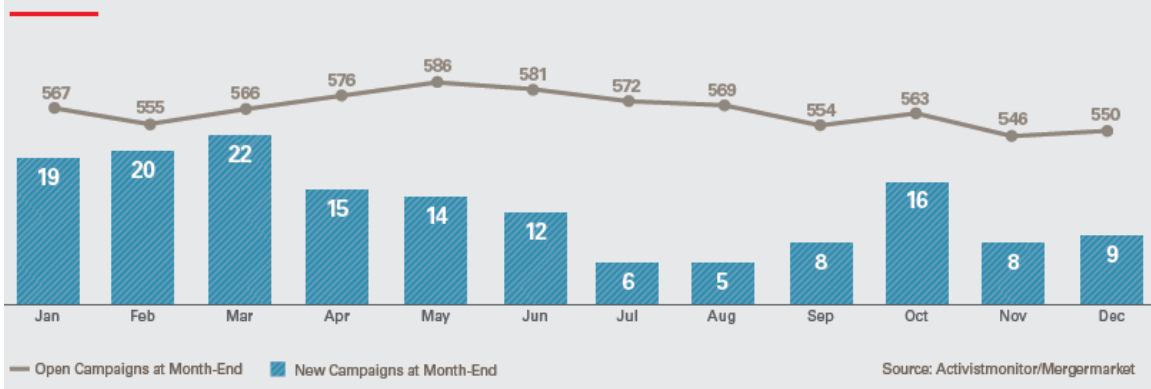
Assess vulnerabilities and prepare responses. Proactively review your company's vulnerabilities ahead of any activist approach, looking at the business from the activist's perspective. Consider whether alternative financial and business strategies (say, a divestiture, spinoff or enhanced return of capital) could boost shareholder value. An open-minded review can go a long way toward reducing the risk of an activist intervention.

Develop a defensive plan. Implement a stock surveillance warning system to monitor new shareholdings, have a shareholder rights plan ready to implement if an activist acquires a substantial stake, assemble a team of advisers and prepare a playbook in case an activist emerges. Another tool being used more frequently is a "table-top" simulation of different activist scenarios to test and refine a company's reactions.

Early board involvement is critical. If an activist surfaces, it is crucial that management alerts the board immediately so directors are educated and are actively involved in the response. To avoid missteps, the board and management must be aligned in their approach and coordinate both internal and external communications.

* * *

Activist Campaigns January-December 2020





How Boards Can Prepare for Activism's Next Wave

Posted by Chris Ruggeri, Joel Schlachtenhaufen, and Annie Adams, Deloitte

Editor's note: Chris Ruggeri is a Principal, Deloitte Transaction and Business Analytics, Deloitte & Touche LLP; Joel Schlachtenhaufen is a Principal, M&A Services Deloitte Consulting LLP; and Annie Adams is Senior Manager, M&A Services Deloitte Consulting LLP. This post is based on a Deloitte memorandum by Mr. Ruggeri, Mr. Schlachtenhaufen, Ms. Adams, Maureen Bujno, and Bob Lamm. Related research from the Program on Corporate Governance includes [The Long-Term Effects of Hedge Fund Activism](#) by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum [here](#)); [Dancing with Activists](#) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum [here](#)); 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. (discussed on the Forum [here](#)).

Introduction

As we begin to see the light at the end of the tunnel of a pandemic that upended all of our lives and disrupted almost every business, activist investors are getting in gear, and the pieces are expected to be in place for continued growth in merger and acquisition activity through 2021. Political unrest, accelerating social change, and renewed emphasis on corporate purpose beyond shareholder primacy will continue to shape the future and inject uncertainty. Our world is literally changing before our eyes, and we have to ask ourselves, how will this affect shareholder activism in 2021 and beyond, and what will the impact be on M&A activity? And how have the events of 2020 changed what board directors need to do to be prepared for M&A generally and to deal with activists that might emerge?

The 2020 slowdown set the stage

Activist investor activity slumped in 2020 as the pandemic rattled markets, managements, and investors. Globally, 652 companies were subject to activist demands through the first three quarters of 2020—the slowest pace since 2015.¹ The drop was also pronounced in the United States, which saw the fewest activist campaigns since 2014. 2021 could show a reversal of this trend with a growth in shareholder activist campaigns.

The issues that sidelined activist investors for a time, such as overtaxed management and volatile markets, have eased. And new campaigns are likely to come quickly, with a growing focus on M&A.

With 2021 likely to be a busy year for activist campaigns, boards need to be ready. The evergreen advice that they must think like activists will be more important than ever. But there's

¹ *Activist Insight*, October 2020.

an added layer. Boards also need to be informed about and proactively engaged with the dramatic changes that have occurred in society, affecting the business landscape and their company. They need to think ahead—to have and be able to articulate the vision and strategy that will allow their companies to thrive through whatever comes next.

Activism in 2021: The landscape has changed

Board members need to understand what factors will likely motivate activist investors in 2021 and be ready to grapple with key issues that activist campaigns could put on the table.

As a starting point, the underlying rationale for activism—that it’s possible for an investor to identify opportunities that a company could take to boost value—hasn’t changed. However, considerations for the board have. To be sure, in the early months of the pandemic, the attention of corporate leaders was focused on the safety and health of customers and employees. Activists took a pause given health, political, and capital markets uncertainty. As the environment stabilizes, questions about the right path forward for any company to thrive are again front and center. Shareholders are seeking a role in shaping that future, and boards need to be prepared to balance a broader and more diverse range of sometimes competing stakeholder interests in decision making.

Activist investors are also getting a tailwind from the recent M&A rebound. Activists have traditionally seen M&A campaigns as among the leading options for increasing returns to shareholders, whether angling for companies to shed assets or merge with peers (see figure 1).

Figure 1. 2020 YTD campaign objectives²



² Lazard's Quarterly Review of Shareholder Activism – Q3 2020.

After a period in 2020 when deal markets were quiet and valuations volatile, M&A activity is on the rise, with high corporate cash levels, low interest rates, and continued political uncertainty. Fifty percent of campaigns by activists in the 2020 third quarter had an M&A angle, up from just a third in the 2020 first half.³

The pandemic itself may be one possible stimulus for this greater M&A activism. Many businesses saw significant disruptions in their operations and shifts in their competitive position as a result of COVID-19. These and related changes may give activists the seeds for future campaigns in which they challenge the strategic decisions management has made to address the new circumstances. Furthermore, this environment has put pressure on the balance sheets of some companies that have struggled financially, which may create activist exposure. Therefore, activists are expected to opportunistically launch M&A-related campaigns, with a focus on companies that are underperforming and undervalued.

Nevertheless, opportunistic M&A campaigns may have new considerations given the increased focus on corporate purpose. The groundswell of social and political unrest, as well as the recent focus on corporate purpose, is changing the landscape. Customers are increasingly choosing to do business with companies that align with their values, and investors are increasing their ESG (environmental, social, governance) expectations on the companies in which they invest. How these trends affect activist investing remains to be seen and will likely put more pressure on board directors to consider the impact and preferences of any given transaction on a wider array of stakeholders.

In another intriguing example of how dramatically things have changed in the past year, labor productivity in the United States jumped even as companies scrambled to adjust to the economic upheaval. Worker productivity growth in the United States had been essentially flat in the decade since the Great Recession, but through the first three quarters of 2020, it jumped. This may be a macroeconomic clue that points to unexpected value in our new ways of doing business—increased digital interaction with their customers, or workforce changes such as work-from-home. Activists are likely to see in this and other “disconnects” new opportunities for boosting margins that can be added to their playbooks. As a result, we may see activists pushing companies to pursue digital transformation or change product mix based on the lessons of the crisis.

It may be a truism that after any slump in any market, a rebound comes. But activist investors are poised to do more than simply bounce back in 2021, given the array of factors that are aligned to motivate and expand their efforts in the aftermath of our pandemic year.

The active board: Preparation and response

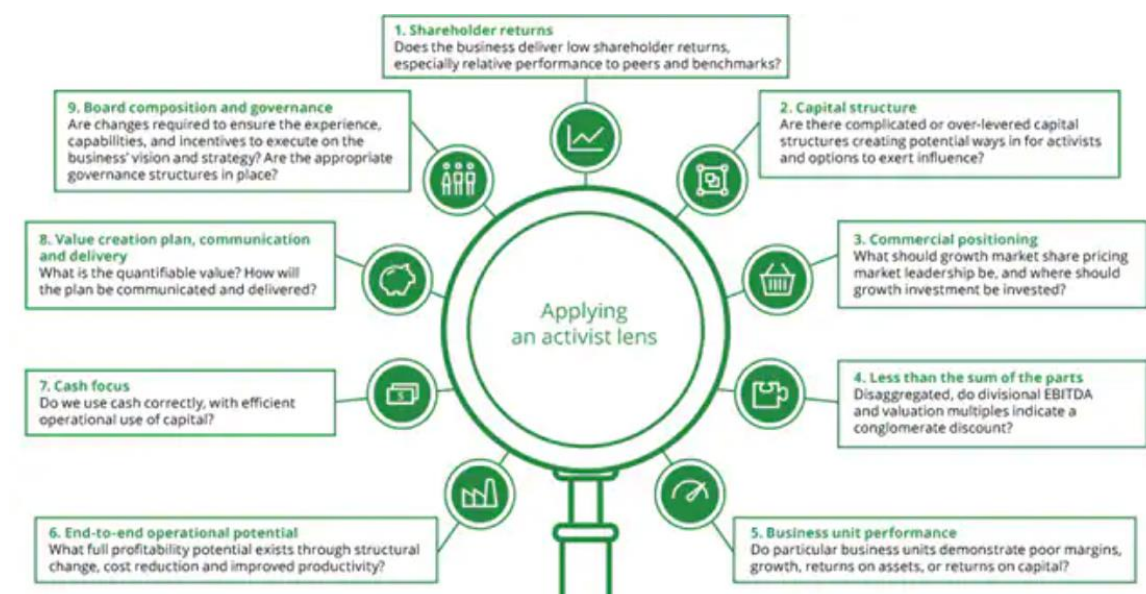
The traditional guidance to boards—that they should think like an activist—gains weight and relevance during a time of upheaval, not to mention a period when a surge in activist investor campaigns may be expected. Accordingly, a starting point for boards is to acknowledge that activists fill a role. Board members need to engage proactively with the ideas and strategies these investors put on the agenda, principally that managements and boards should focus intently on how they plan to maximize both short-term and long-term value.

³ Lazard's Quarterly Review of Shareholder Activism – Q3 2020.

Activists will typically look in three main areas: potential to grow revenue, potential to boost margins, or potential portfolio changes. Boosting margins will often be preferable to revenue growth, as smaller gains have a bigger effect. (Raising a business's margins from 5% to 6%, for example, can yield as much extra cash flow as a 20% revenue increase.) Portfolio changes are the most common focus, as already mentioned, and they have potential to give activists their biggest wins.

Our Deloitte guidance in the past has been framed around the idea that managements and boards should be able to keep control of the company's fate, and this remains the operative principle. To do this requires self-assessment across a number of factors, such as how efficiently the company uses cash, whether its capital structure is fit for purpose, and refreshing the view of the risk landscape, risk profile, and risk appetite of the company (see figure 2).

Figure 2. How to be your own activist: A rigorous self-assessment⁴



Given the dramatic shifts of the past year, a proper assessment may demand a new focus on competitive position and market environment. For many companies, competitive positioning will likely have shifted in ways large and small in the past year. The relative performance of specific business units may also have been altered, and this is often a key area for activist attention, with a cold eye on operations that should perhaps be divested. A disaggregated analysis of divisional cash flows and valuation multiples may look very different today than it did a year ago, pre pandemic.

Board members should be ready to articulate a company's strategic vision, which is why the above steps are so important and need to be up-to-date. They may need to articulate this publicly to all their shareholders, or privately when approached by an activist. Either way, they should be

⁴ Deloitte, *Be your own activist: Developing an activist mindset*.

prepared to tell the story well before they are called upon to do so—and should demand of management a clear articulation of the company’s strategy and all relevant analysis to support it.

Given that portfolio options are in play, managements and boards should give careful consideration to where the company might be pruning and where it should be grafting. The pickup in carveouts and divestitures, which is already in evidence as M&A activity rebounds from last year’s slump, suggests companies are making strategic moves in response to the changes caused by the pandemic. Such moves may anticipate activist efforts to some extent and may show how boards and managements already have an activist viewpoint. Still, this is only beginning to play out, and activists may well see M&A moves that companies so far have rejected or failed to consider.

The M&A ideas in activist campaigns can vary. In 65% of the campaigns that had an M&A agenda in 2019, the activist goal was the sale of the company, the divestiture of noncore assets, or a full breakup of the company.⁵ In the balance of M&A-focused campaigns, opposition to a proposed transaction was the driver. In these cases, activists may be trying to boost the value of their position in a proposed deal, or they may believe a proposed transaction simply is not in the best interest of shareholders and should be blocked.

To truly have an activist mindset today, it has also become necessary to examine how the nature of activist campaigns has been changing. For one thing, there has been growing involvement by traditional long-only institutional investors. *Activist Insight*⁶ highlighted that 93% of institutional investors have become more accepting of activist investors in the past 12 months than in the past few years. Also, the field of play for activism is shifting to be more global. Boards of non-US companies may be wise to pay particular attention to the possibility that activism may finally reach their companies. And directors newly named to companies that become public through SPAC transactions should also be aware that their companies may quickly find their strategy and progress challenged by activists.

Overall, however, the fundamental principle to guide all board members should be to cultivate the ability to listen carefully and understand where activists are coming from. Recognize that investors make a choice to own your stock as a basic first step, and ask why investors are in your shares rather than a competitor’s. It’s a question that can inform much of what your company then does.

Conclusion

The year 2021 is expected to see growth in both shareholder activism and mergers and acquisitions. As a board director, the traditional advice to think like an investor has not changed, but the world around us certainly has. Continue to be prepared in identifying issues that might attract activists’ attention, proactive in communicating your strategy, and responsive to shareholder needs; consider how recent trends, such as political and social change and renewed corporate purpose, may change priorities for your stakeholders; and have a clear plan on how to

⁵ Lazard’s Quarterly Review of Shareholder Activism – Q3 2020.

⁶ *Activist Insight*, October 2020.

respond if an activist launches a campaign to be able to maintain control of the situation from Day 1.



Shareholder Activists Gear Up for a Busy 2021 – With New Tools and Tactics

Posted by Bruce H. Goldfarb and Alexandra Higgins, Okapi Partners, on Monday, March 1, 2021

Editor’s note: Bruce H. Goldfarb is the President and Chief Executive Officer and Alexandra Higgins is a Managing Director at Okapi Partners.

As we near the end of the first quarter of 2021, the number of activist campaigns appears to be on track to outpace last year. In a recent poll of readers, activism research provider *Insightia* found that 59% of readers surveyed expected an increase in the number of companies targeted by shareholder activists this year compared to 2020.

Corporate management teams also face a very different operating environment from the one that prevailed throughout most of 2020. Last proxy season, the combination of economic disruption and the view from some market participants that the timing wasn’t right to wage a proxy campaign, slowed activism. But just as quickly as the markets recovered, activist investors started training their sights at possible targets again.

A key difference this year is that many of the changes in our economy and society that emerged in 2020—including a heightened focus on social justice, racial equality, climate change and other ESG issues—will increasingly find their way into the tactics used by activist shareholders.

Reddit, Robinhood and the Resurgence of Retail Investors

What’s more, the GameStop fiasco reminded companies and activists that retail investors can be an extremely influential constituency. Some activists may be hesitant to target a company with a big retail shareholder base, which has traditionally been viewed as pro-management, but others will conclude they can effectively use those small investors to their advantage if they have the right message. While each situation is different, the reality is that the Robinhood/Reddit investor base is much less predictable than large institutional shareholders. Getting retail investors to vote in any proxy fight can be expensive and requires a very smart and tailored strategy.

Retail investors, along with institutions, may also be persuaded by certain ESG issues. These issues have played a central role in activist campaigns in recent years, and we believe the number of ESG-related proxy proposals will only increase in 2021. Expect activists targeting underperforming companies this year to inject ESG issues into their arguments where relevant.

An Increasing Focus on ESG Policies and Performance

Significant capital has been raised in ESG-focused funds over the past year and both activists and companies will court their vote during any proxy fight. The AUM of investment firms and other

asset owners who have signed the United Nations' Principles for Responsible Investment totaled \$103.4 trillion at this time last year, an increase of 28% in 2020, on top of a 20% increase for 2019, according to [State Street](#). With respect to proxy proposals, more than 850 shareholder proposals related to environmental, social or governance issues were filed and 71 passed during 2020.

Companies are certain to face even more proposals on climate change, diversity and inclusion, racial justice, socio-economic inequality, health and safety, and other ESG-related factors in 2021. Activists will also make some of these proposals part of their demands. In December, CalSTRS announced [support](#) for a slate of alternate directors at Exxon Mobil Corp. put forth by new activist Engine No. 1 in a campaign partially on emission reduction issues.

Some boards of directors may be tempted to dismiss an activist investor's focus on ESG as a cynical ploy to exploit the current zeitgeist. But, the fact remains that many investors—not just activists—view ESG factors as material elements of a company's performance—and a failure to address such issues as a significant risk to value.

Taking Companies to Task on Cybersecurity and Covid-19

Given the rising tide of cybercrime, activist investors will likely begin to focus on this issue as a major risk to value, much as they have done with ESG factors. In late 2020, the world learned of sophisticated cyber-attacks on several US government agencies and corporations, which were apparently facilitated by compromising an outside software provider used by those organizations. These attacks are just the latest and most dramatic examples of the enormous threat to companies from cybersecurity incursions, including (but not limited to) malware, spyware, data breaches, ransomware, financial cybercrime, and compromised business e-mail. Global losses from cybercrime in 2020 have been [estimated](#) at nearly \$1 trillion, up from \$600 billion in 2018.

Obviously, a company that has already suffered a cybersecurity breach could be more vulnerable to an activist's criticism on that score. According to a [survey](#) by PwC, only 32% of corporate directors think their boards understand their companies' cybersecurity vulnerabilities. Therefore, it seems likely that activists may try to nominate candidates with cybersecurity credentials to serve on the boards of target companies that lack such expertise.

With the benefit of hindsight, activist investors this year also may challenge how well management and the board responded to the Covid-19 crisis. Arguably, it may be hard to criticize a company for failing to anticipate such an unprecedented event. However, activists might assert that management did not fully disclose the financial and operational impact of the pandemic, or did not take appropriate actions to sustain the business through the crisis, keep employees safe and protect stakeholders. The SEC's decision to file [charges](#) against a restaurant company for alleged "misleading disclosures about the impact of the pandemic on its business operations and financial condition" suggests that activists may see this concern as a viable line of attack.

Determining Whether You're an Activist's Target

As issues such as ESG, cybersecurity, Covid-19 response and the rise of the retail investor join the more traditional elements of activist campaigns, a logical question for corporate boards and managements is: How can we tell if we're going to be targeted by an activist?

A key part of the answer is to assess the same vulnerabilities of your company that a potential activist would. Compare your financial performance to your industry peers, and look for weaknesses that might be cited by an activist. Ask yourself whether there are aspects of the company's operational capabilities that could be improved, particularly in terms of cybersecurity. Look at your board of directors and assess whether the right skills are represented. With respect to ESG issues, consider whether the company could be vulnerable to criticism in areas such as climate impact, diversity and inclusion, or corporate governance. Even if the company is not a leader in these areas, having well-defined and well-articulated goals and policies may be helpful in responding to an activist challenge

Finally, there is no substitute for knowing—and engaging regularly with—your shareholders. When activists are assessing their chances of prevailing in a campaign, they try to understand who the other shareholders are and what issues concern them. If your management and board have maintained an open channel of communication with shareholders, it's less likely that an activist will uncover some heretofore undiscovered area of disagreement that can become the focus on a successful campaign.