ACTIVIST INVESTORS AND MEDIATION

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I. INTRODUCTION

Activist investors have the capacity to play a commanding role in a company after they invest in it. Sometimes, these investors are dissatisfied with some aspect of the company, from its structuring, to its earnings, or future expansion or investment plans. In very few instances does an activist approach a company and have the opportunity to be heard by the board in a non-confrontational setting. More commonly, the activist will wage a proxy battle to be acknowledged. The goal of this battle usually aims at removing current board members and replacing them with individuals of the investor’s choice, who will subsequently act as the investor sees fit. The targeted company tends to push back, almost instinctually. The activist investor must convince other shareholders to back him in his endeavor. Other shareholders will then allow the activist to use their votes via the proxy system to create change. This tends to play out in very public battles. The key to a successful proxy battle hinges on creating persuasive messages for other shareholders through the media. Often, papers are sent from the investor’s attorney directly to the company before there has been no opportunity to have a face-to-face meeting and truly discuss points of concern. Perhaps the opportunity to have a true meeting of the minds would eliminate the need for a battle of any sort and companies and investors could move forward more efficiently.

The relationship between activist investors and their investments is one that deserves attention today. These potentially volatile dynamics are becoming increasingly more common.1 “Activist hedge funds now manage more than $120 billion. With such heft, they are growing increasingly aggressive in their demands from senior management—and often getting their way. Warren Buffett . . . expressed concern that activists were causing companies to do share buybacks that made little sense.”2 Activist investors play a


major role in many companies, and whether it is buying back shares or taking any other actions, the relationship between activist investors and their investment companies should not be characterized by one party forcing the other to act if there is insufficient rationale behind the action.3

In order to ensure that each side has had the opportunity to express their position on any given matter, a conversation would have to occur. One way to begin that conversation would be to create an appropriate time period and setting for discussions. A company’s organizational documents should adopt a mediation clause for shareholders to invoke if they wish to take an active role within the company. This would create an opportunity for discussion, and ideally avoid proxy battles.

II. BACKGROUND

Shareholder activism can play many roles. In some cases, shareholders can help turn a failing company around or simply help to improve a company’s standing in the market. This would generally be considered a positive relationship. Conversely, however, shareholders have also proven to be corporate raiders.4 In such cases, they have encouraged a company to make a business decision that would unlock cash now, allowing the investor to take their profits.5

The usual knock on activist shareholders is that they are looking for a quick payout so they can take their profit and move on, leaving behind a weaker company less well-equipped to face the future. In bigger companies, where the stock enjoys heavy trading volume—and, therefore, large shareholders can quickly exit their positions after extracting, say, a special dividend payment.6

The investor, or raider, would then sell his stake in the company, leaving the company in a worse off long-term position than

3 See id.
when they invested in it. Over the years, this has happened enough times, in different industries, to leave corporate management and board members truly fearful of being raided. In 1989, a $25 billion takeover of RJR Nabisco became so infamous that it inspired a movie called Barbarians at the Gate. Although shareholder activism is not all negative, the fear of it is ever-present.

A. Activist Investor Examples

The ideal relationship between a substantial shareholder of a company and that company is one where the shareholder adds value to the company. This requires the company, or its representatives, to make themselves available for a conversation with the shareholder. This implies that the company should not immediately act defensively.

In situations where shareholder activism is seen as bullying to the board of directors, the situation receives a great deal of media attention, which reflects poorly on the company. A company wants to be highlighted in the media for its successes, not because one of its investors is unhappy with their investment. One example of this was the relationship between Trian Fund Management, an eleven-billion-dollar hedge fund, and DuPont. This dynamic played out very publically in May of 2015. Trian’s CEO, Nelson Peltz, wanted to restructure DuPont by selling off various branches of the company. He said that if that was not done, he wanted four board seats to be occupied by people of his choosing, which DuPont feared would inevitably lead to the same restructuring plan. Peltz essentially wanted to “break-up the company, add Garden and another executive to the board, or face a proxy fight.”

7 See Carlisle, supra note 5.
10 See id.
11 See Gandel, supra note 2.
12 See id.
13 See id.
14 See id.
15 See id.
16 See id.
DuPont was founded in the early 1800s and is generally regarded as an established and well-managed company. This reputation has continued under CEO Ellen Kullman’s helm. “For the six years through the end of 2014, according to FactSet, DuPont had produced a total return for shareholders of 266% vs. 243% for the average S&P 500 chemical company and 159% for the broad S&P 500 index.” This was not a company that was failing by any measurement. “Just because a company is performing well does not mean that it is performing optimally, or that it doesn’t have areas where it could improve or explore value-enhancing alternatives.”

Peltz and his managers might have had some valuable ideas for DuPont’s long-term success, but the immediate issue was how Peltz approached DuPont and Kullman. Kullman was ultimately successful in rebuffing Peltz’s demands, but this result was considered a coup for Kullman. This was not seen as an expected victory for DuPont, but rather a surprising one given how aggressively the activist investor attacked the company.

Kullman was able to avoid acquiescing to Peltz’s demands because she lobbied for support from the other investors, who ultimately supported her and not Peltz. “Sources close to the company say the vote is close.” This battle created two teams, that of Kullman and that of Peltz, between which other investors had to choose. At the time, it sounded like a strategy game:

It’s essentially down to four major shareholders—large mutual fund and asset management companies. In case one of those flip, sources close to DuPont say the board has been contemplating a settlement offer with Trian that might include putting Peltz or another principal of the hedge fund on the company’s board, something Kullman has fought to avoid for nearly two years.

Despite Kullman’s success, it still brought the company under immense public scrutiny. This is the exact type of public relations

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18 See Gandel, supra note 2.
19 See id.
20 See id.
22 See id.
23 See Gandel, supra note 2.
24 Id.
25 Id.
26 See id.
fiasco that every company wishes to avoid. “DuPont’s first and perhaps biggest mistake was not realizing early on that, to a large extent, the contest with Trian would be waged in the court of public perception.”27 Perhaps this battle would have ended quickly if Kullman had realized this, but even so, it is unlikely that the company would not have been put under some sort of public relations strain.

“Experts say DuPont’s victory is a reminder that if management believes in what it is doing, it should stand firm and force activists to take their battle to the end of the line.”28 The fear here is that the process will take an equally damaging toll on the company, as would their acquiescence to whatever the activist is proposing. The idea of fighting until the end is one of ego. DuPont’s victory helped motivate companies to hold their ground: “There is no question this is a shot in the arm and a confidence builder for companies,” said Dechert LLP partner William Lawlor.29

DuPont won against one of the most highly respected activist investors in the shareholder universe.” Lawlor, who is head of corporate governance at Dechert, pointed out that DuPont’s victory is likely even more satisfying because of the fact that at least two highly respected independent proxy advisers, Institutional Shareholder Services Inc. and Glass Lewis & Co. LLC, told shareholders they should side with Trian.30

Conversely, it is important to remember that when an activist investor’s intentions are not realized, it can mean major financial loses for that investor.31 The investors have huge sums of money invested, which is why they are generally willing to wage such ferocious battles. Bill Ackman’s fund, Pershing Square, sold its stake in J.C. Penney in 2013.32 Pershing Square owned eighteen percent of shares, but was not able to help J.C. Penney improve its market value, despite attempts to do so.33 This failure represented an estimated loss of $700 million to Pershing Square.34 Again, perhaps if J.C. Penney had been able to work more proactively and produc-

27 Id.
28 Horney, supra note 21.
29 Id.
30 Id.
32 See id.
33 See id.
34 See id.
tively with Ackman, the health of the company would have improved, benefitting both the company and Pershing Square.

Unlike Kullman, William Ruprecht, CEO of Sotheby’s, was not successful at defeating driven activist investor and then-board member Dan Loeb of Third Point. Ruprecht failed to thwart Loeb’s demands, which literally resulted in his stepping down as a part of Loeb’s plan to cut costs around the company.

Carl Ichan, another prominent activist investor, has waged many public battles with companies that he has invested in. In the 1980s, Ichan was seen as a corporate raider, but today he is characterized as a very aggressive activist investor. “Since January 2014, Icahn has had seven notable activist campaigns: Freeport, Cheniere Energy Inc., Manitowoc Co., Hertz Global Holdings Inc., Gannett Co., Family Dollar Stores Inc. and EBay Inc. . . .” He has reached settlement agreements in six of those seven campaigns, with five resulting in board seats. This is but one example of a driven activist investor who is known for accomplishing his goal.

In an ideal world, the dynamic between activist investors and a company results in a productive improvement for that company. One productive relationship between a company and its investor was between insurance company, The Hartford, and activist investor John Paulson of Paulson & Company. Although this investment was on a much smaller scale than the previously discussed companies, the two employed respectful communication to come to a middle ground.

Liam McGee, former CEO of The Hartford, no doubt used some of these techniques in 2011 when he was approached by activist John Paulson of Paulson & Company. Instead of ignoring Paulson, McGee had his team thoroughly analyze and test Paulson’s ideas. Then he worked harder on his own reorganization plans and negotiated behind the scenes with Paulson in-

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36 See id.
38 See Carlisle, supra note 5.
39 Atwood and Jinks, supra note 37.
40 Id.
stead of fighting in the media and circling the proverbial wagons.\footnote{Id.}

This rare example of negotiations should be the standard. Even if they had not found a middle ground, a straightforward conversation would have prevented, at least at the onset, The Hartford from having to deal with added public scrutiny. There is no reason to leave this type of ideal situation to chance or to the personalities of the individuals involved. Certain steps and measures can and should be taken to require both sides to come together in an attempt to find a proactive middle ground.

B. \textit{Corporate Structuring and Proxy Votes}

Few individual investors own significant enough portions of a company to be involved in the day-to-day activities.\footnote{See id.} Thus, proxy solicitation, or the request of one shareholder to vote on behalf of another minority shareholder,\footnote{See Jason Van Bergen, \textit{Proxy Voting Gives Fund Shareholders A Say}, INVESTOPEDIA http://www.investopedia.com/articles/basics/04/082704.asp?partner=fdc (last visited Jan. 22, 2016).} is required for a vote that will carry weight.\footnote{See id.} In order to solicit proxy votes from the minority shareholders, activists must present their ideas to the other shareholders, which is sometimes done, before presenting them to the board of directors.\footnote{See id.} Shareholder voting is generally centered on the nomination of board members, although proposals can also address other corporate governance matters.\footnote{See Picardo, supra note 31.} These include the makeup of the management team and their compensation, or potential spin offs of a portion of the company to increase liquid cash to shareholders.\footnote{See id.} Generally, an increase or decrease of dividends helps to signal a company’s success and health, so an activist may be looking to distribute special dividends to shareholders.\footnote{How and Why do Companies Pay Dividends, INVESTOPEDIA, http://www.investopedia.com/articles/03/011703.asp (last visited Jan. 22, 2016).} Other merger and acquisition issues may also be a point of concern or interest.\footnote{See Hinkel et al., supra note 1.} Sometimes the goal of an activist investor is not immedi-
ately identifiable.51 An unclear objective automatically puts a company on the defensive.52 The only certain assumption a company can make is that the activist investor intends on improving their own returns.53 This type of nebulous action accounts for only a minority of the cases of activism and it would be a much healthier tactic to consider activist investors as “strategic reformers.”54

Activists have a bad reputation for coming into companies, making changes that spin off big returns, and then leaving the companies in a worse position than they were in initially.55 Although it is frequently assumed that the motives behind their strategies are self interested, “[a]n activist critique of the company’s financial or operating strategy could be constructive in nature. Because each activist situation should be individually evaluated, it may be unwise to establish detailed advance preparation playbooks that seem to suggest that the board will reject out of hand any overture by an activist.”56 Activist investors generally have the capital to wage a proxy battle to accomplish their goals, which an individual investor would not have the capacity to do, but “[a]ctivist shareholders are some of the smartest investors around, and . . . their willingness to engage in a proxy fight is a concrete indication of the courage of their convictions, i.e. they are willing to go the distance to drive positive change.”57 Activist investors who want to sell a portion of the company, restructure inefficient operations, or add additional disclosures are significantly more successful in their proxy battles than activist investors who try to get higher dividends or repurchases, remove a CEO, or change executive compensation.58

We see such specialized actors in the capital markets—activist investors of various types—and indeed a complicated interaction between the actors and the institutions has arisen whose shape has been described in a recent comprehensive study by Nickolay Gantchev of 1,164 activist campaigns over the 2000 to 2007 period. It is interesting that the activists often achieve their

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51 See id.
52 See id.
53 See id.
54 See id.
55 See Van Bergen, supra note 44.
57 Picardo, supra note 31.
state objectives but not invariably: They succeed in approximately 29% of the cases.59

A company can track which of their investors may be powerful enough to solicit proxy votes to effect change. Regulatory filing requirements, specifically SEC Schedule 13D, requires a person or group who acquires more than five-percent of any class of a company’s shares to disclose such action within ten days of the transaction.60 Five-percent is usually a significant enough portion of a publicly traded company to realize change.61

D. Current Techniques to Ward Off Activists

Companies currently employ different strategies to ward off activist investors. These strategies are employed for different reasons, but no one strategy is considered foolproof.62 Staggered boards are becoming a common structure for companies to help slow the processes of proxy battles.63 They help protect companies by forcing bidders to wait one year before they can effectuate control, requiring bidders to win at two elections, instead of just one, and making that requirement span a set period of time instead of back to back elections.64 These are the types of bylaw amendments and structuring considerations that are becoming more common because companies and their boards of directors are trying to advance plans to make sure they are protected from hostile actions.65

Additionally, companies sometimes employ what is called the poison pill strategy to ward off any version of a hostile take over.66 The idea of a poison pill is that a board makes its stock less attractive so that investors shy away from it and therefore do not acquire enough to implement any takeover plans.67 This is a concept that is not beneficial to a company in the long-term and thus should not

59 Id.
61 Id.
63 See id.
64 See id.
65 See id.
be employed. If investor relations are improved, no poison pill strategy would be considered or employed.  

A strong investor relations management system has five key components which include a realistic internal valuation of the company, clearly understanding what gaps may exist between the internal valuation and the market valuation, a plan as to how to approach critical investors so that they are clear and on board with the company’s direction and messaging, and a concrete system to manage investor frustrations as marked by key successes of the company that are replicable. This type of thinking and advanced planning is what our proposal directly supports. Creating a system that goes beyond the anticipation of shareholder activism to create a framework for shareholders to work with management is the ideal way to prevent activist investors from waging battles with current boards of directors which result in irrational decisions for the company’s long-term health.

E. The Nature of Proxy Battles

Certain aspects of a proxy battle must be noted to understand the subtleties of why they are so damaging to a company’s well being. The extraordinarily hostile battle language that is employed must be addressed. One party is the aggressor, and the other party stands on the defensive. Usually, the activist investor is the initial aggressor, although in response to the activist, a company may also be antagonistic. Third parties and consulting agencies produce publications on how to best ‘defend’ a company from hostile investors. In the most civilized and elegant of terms, it is seen as a contest. “Fight Letters” are compiled to reach out to other investors for support, but the nature of the “Fight Letters” naturally escalates the situation. The timing of the battle is key from all strategic perspectives. From the view of the activist investor, it is
best to have zero mistakes in any publications so that an injunction cannot be imposed.\textsuperscript{74} The idea is that the activist who initiated the contest will move at a faster pace than the company, making their campaign more effective.\textsuperscript{75} From the perspective of the corporation, the faster and more effectively it can respond to the activist investor’s actions, the more likely it will be to be able to ward off any and all unwanted actions.\textsuperscript{76} Each side is trying to lay out its agenda to the other shareholders to gain support first.\textsuperscript{77} Essentially, these actions do not reflect what may necessarily be best for the company and its long-term success, but rather how one side may beat, win, or overtake the other side.\textsuperscript{78}

Another noteworthy factor of proxy battles is their cost to both parties.\textsuperscript{79} Specifically, the cost of external advisors can weigh heavily on a company regarding both time and money.\textsuperscript{80} Examples of external advisors include outside counsel, public relations firms, and factual investigators. Proxy solicitation firms are also employed, as they help inform shareholders of upcoming elections and explain why a vote in a particular way is in their best interest.\textsuperscript{81} For example, Institutional Shareholder Services is one of the largest in the United States, monitoring 20,000 firms around the world and advising more than 700 pension and mutual funds.\textsuperscript{82} They lay out the situation for institutional and individual shareholders and include a recommendation as to how the shareholder should vote.\textsuperscript{83} Having to work with external advisors distracts from conducting regular business.\textsuperscript{84}

Another critical element of proxy battles is the nature of the people involved. The personalities of various activist investors and of corporate directors are usually that of resolute and determined individuals. Particularly on the side of the activist investors, there are many individuals who are known for their ruthlessness. There are many investors who maintain very public and large personali-
ties, partly because they deal with such substantial amounts of money.85 Sometimes when the key individuals know each other personally, or have previously gone to war over another company, the back and forth can be endless. It is not uncommon for the back and forth to then become juvenile and even result in name-calling.86 Some surefire ways a company can fail—particularly in communication—during proxy battles include: Resorting to personal attacks, refusing to interact with the dissident, assuming the shareholders or the media will see through the dissident’s unfounded arguments, complicated messaging, trying to dissuade the dissident with actions inconsistent with the long-term objectives of the company, thinking that inflexibility is a sign of strength against dissident shareholder, and jumping too quickly to discount a negative recommendation from a proxy advisory firm.87

Additionally, with past success comes the expectation of future success, and when a successful investor takes an interest in a company, it may help the stock simply because of the investor’s reputation. Carl Ichan, for example, maintains a website where he refers to himself as a “leading shareholder activist.”88 He confidently states that his “efforts have unlocked billions of dollars of shareholder and bondholder value and have improved the competitiveness of American companies.”89 This display of confidence plays into the overall dynamic between companies and their activist investors.90

F. Proxy Access Proposals

Shareholders of a company may solicit a change, usually by way of nominating a new board member, during the company’s annual meeting or other periodic meetings. Under the SEC’s Rule Exchange Act, Section 12, Rule 14a-8(i)(8), a shareholder can include his nomination in the company’s proxy statement if he com-

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86 See Macaulay, supra note 77.
89 See id.
90 Posner, supra note 87.
plies with certain eligibility and procedural requirements, and the proposal is not excludable under one or more of the 13 substantive exclusions. This nomination would go directly onto a company’s proxy materials. This carries a ton of potential weight for activists because it places their nomination next to the names of whomever the board nominates, making it visually equal for the voters. If the activist does not get his nominee on the company’s proxy materials, he undertakes the cost of printing and postage to distribute information about the new nominee to all other investors.

Companies that do not want to include investors’ proposals in their proxy statements can look to the SEC. The SEC in turn assesses the situation to see if each requirement under 14a-8(i)(8) has been satisfied. Specifically, it will look to see if a material omission or misstatement has been made. Notable requirements specify that proposals may not address a personal grievance or special interest unless it is relevant to all shareholders, and that proposals may not directly conflict with one of the company’s own proposals being submitted at the same meeting. If the shareholder does not meet all the requirements, the SEC will return a “no-action” letter. This type of letter means that the SEC would not take action against the company for not including the investor’s proposal. Alternatively, under the Securities and Exchange Act of 1934, Section 27, the parties can seek remedies in federal court if they feel the SEC has not responded in the appropriate manner. The huge cost of taking this type of matter to court is prohibitive in most cases. Although it is important to have this remedy available, this is a remedy of last resort for both companies and shareholders. There has been much debate, particularly in the DC Circuit, surrounding the implementation of a mandatory proxy access rule, and as it currently stands there is not one. There has been an expansion of the private ordering of proxy access, which highlights why a mediation clause would likely be well received.

94 See id.
Proxy access proposals have increased in the last few years. As of August 13, 2015, eighty-two shareholder proxy access proposals have come to a vote in 2015, and forty-eight have passed.\textsuperscript{95} This compares to only seventeen proposals in 2014.\textsuperscript{96} More money is flowing into activist funds from places like pensions funds, which was atypical before.\textsuperscript{97} “Activist funds now have over $200 billion in assets under management, and as a class, they outperformed all other hedge fund strategies in 2014.”\textsuperscript{98}

III. DISCUSSION

The relationship between activist investors and companies can be improved. As examples of both successful and unsuccessful relationships have played out, the need for a civilized forum is clear. The best way to create this type of venue would be to codify a framework in the company that all investors agree to when they invest in that company. The place for this framework is in the bylaws.

A. Bylaw Amendment Trends

Bylaws are a set of rules that are established at the founding of a company which are followed by the company’s members and its investors. A voting process that is described in the initial operating documents can adjust this framework of rules.

Bylaw amendments have been made with more frequency in recent years to address the issue of shareholder activists.

Other top charter/bylaw defense changes in 2013 illustrate the continuing trend of companies dismantling takeover defenses, increasing shareholder rights and implementing other corporate governance “best practices.” Changing the vote standard to elect directors from a plurality standard to a majority and de-classifying boards in favor of annually elected directors were


\textsuperscript{96} See id.

\textsuperscript{97} Posner, supra note 87, at 6.

\textsuperscript{98} Choi, supra note 56.
among the most frequent changes. While several of the top changes qualify as removing defenses they nonetheless may help companies defend themselves in proxy fights and value creation activism campaigns because perceived governance weaknesses are typically used against the company as the activist makes its case to fellow shareholders.99

B. 14a-11

The SEC passed 14a-11 in 2010 authorized by Dodd-Frank.100 It was controversial at the time, but it “created a federal right for shareholders to nominate corporate directors, subject to a complex set of conditions. In order to qualify to use federal proxy access, shareholders were required to own at least three percent of an issuer’s stock for at least three years and to commit to continue to hold that stock through the date of the annual meeting.”101 This rule was intended only to get director candidate names on the proxy access proposals.102

The Business Roundtable and the U.S. Chamber of Commerce immediately challenged this in federal court.103 On July 22, the Court of Appeals for the District of Columbia vacated this rule explaining that the SEC had not taken proper account of what the economic effects of 14a-11 would be.104

[T]he Commission has a unique obligation to consider the effect of a new rule upon “efficiency, competition, and capital formation,” 15 U.S.C. §§ 78c(f), 78w(a)(2), and 80a-2(c), and its failure to “apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation” makes promulgation of the rule arbitrary and capricious and not in accord-dance with law.105

The Court also criticized the SEC for relying on research that it deemed “unpersuasive,” particularly in regard to “improv[ing]
board performance and increase[ing] shareholder value by facilitating
the election of dissident shareholder nominees.”

In response, the SEC adopted amendments to Rule 14a-8: private
ordering amendments, like the one that was at issue in ACME
v. AIG. Essentially, the SEC said that it could not include a specif-
cic rule, but it had given companies the tools to accomplish this
on their own for shareholders to adopt through private ordering.

Additionally, 14a-8(i)(9) says that a company can exclude a
shareholder proposal if the proposal “directly conflicts with one of
the company’s own proposals to be submitted to shareholders at
the same meeting.” The definition of what directly conflicts has
been contested in different subsequent cases. “[R]egulators will
not ‘view a shareholder proposal as directly conflicting with a man-
agement proposal if a reasonable shareholder, although possibly
preferring one proposal over the other, could logically vote for
both.’” This complicates the dynamic, but further proves that it
is an ever-present dynamic that is not simply resolving itself.

C. Shift into Local Government

The idea of allowing shareholders to have more of a say in the
companies in which they invest is popular among certain factions.
Particular government officials have come out with firm stances on
the topic since they seem to gain public favor by doing so. These
arguments do not have much research to back them, but rather
they are more generalized arguments that include ideas about fair
representation for all and limiting the amount of power that certain
powerful individuals and corporations wield. Although the mes-
sage may stem from self-interested perspectives, the concept is rea-
sonable. Increasing the say that investors have must be done in a
delicate balance so as to not open the floodgates to activist
investors.

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106 Id. at 1150.
107 Matthew Heller, SEC Gives Boot to Investors in Proxy Battles, CFO.com (Oct. 23, 2015),
108 See id.
109 Id.
110 Heller, supra note 107.
1. The Boardroom Accountability Project

Scott Stringer, the Comptroller for New York City, launched the 2014 Boardroom Accountability campaign. Representing New York City’s Pension Funds, valued at $160 billion, Stringer filed proxy access proposals at 75 companies in which the Pension Fund invested whose ownership met the threshold under 14-a. The proposals requested a bylaw be enacted at each company that allowed shareholders who own only three percent of the company for three or more years to be able to automatically nominate board members for up to twenty-five percent of the board. Stringer targeted companies that he felt were underperforming in three major categories: climate change, board diversity, and excessive CEO pay.

As long-term investors, New York City’s pension funds have an obligation to manage risk and create long-term value on behalf of over 700,000 current and retired City workers. By giving substantial, long-term owners a meaningful say in electing the directors who oversee companies on our behalf, proxy access will help us to provide these hardworking men and women with a secure retirement,” Stringer said.

According to Stringer, the companies that have been approached but have not agreed to support Stringer’s position or consider a change are those where large mutual funds, like Fidelity and Vanguard, are major shareholders. Fidelity oversees over two trillion in assets and Vanguard oversees three trillion. Without support from their large voting blocks, it is unlikely that Stringer’s proposals at those companies will be successful. Vanguard did support the idea of proxy access by shareholders that own at a minimum of five percent of a company. This would be a very high

112 Id.
113 Id.
114 Id.
115 Id.
117 Id.
118 Id.
119 Id.
threshold for access. This concept is not entirely novel, as “investors in some European companies can nominate directors if they hold just a 1 percent stake for at least one year.” Thus far, it has not taken off in the United States.

Having said this, there are various companies that are moving forward with voluntary proxy access. Several large companies have taken initial steps to amend bylaws to allow for proxy access. As of May 2015, some companies had passed an advisory vote to do so, including Abercrombie and Fitch, Staples, and Big Lots. This is not a binding vote but it does show that a shift in corporate governance has begun and both shareholders and companies are acknowledging that there may be advantages to opening up proxy access.

D. Practical Implications

Proxy access proposals may be one way to grant shareholders a greater say in the management and long-term direction of a company, but there are practical considerations that must be considered. Namely, the human element must be addressed.

For example, if a proxy battle is fully waged, there will be a winner and a loser. A shareholder who has spent the effort to launch a war is not going to be a supportive shareholder moving forward if he lost the battle. Equally, if they win, the remaining board members will feel under constant threat and likely not work well with the newly appointed board members who represent the recently waged war.

On the other hand, if proxy access is expanded and a nominated director makes it onto the board, what is the likelihood that that person will be able to effectively work with the existing board if he is always seen as a director of protest? He will likely be the sole representative, as a shareholder is unlikely to be able to successfully propose multiple nominees, and thus, the process could create an island effect for that singular new board member.

120 Id.
121 Id.
122 Morgenson, supra note 116.
123 Id.
124 Id.
assumes the fact that the person posited for the position is even qualified to be there. In many cases, the person up for nomination may simply be a friend of the nominating member who will act as the member’s puppet. This reflects a bigger issue where a new board member who was hoisted into the position by a particular faction of shareholders will feel forever indebted to that faction. The purpose of a board is to have a group of people who work in the best interest of the company, not in the best interest of certain small groups of shareholders. This represents a fundamental issue of loyalty. The countervailing argument here can be said that “...shareholder activism as a movement is good for corporate America . . . . It keeps boards and management on their toes. It really drives companies to perform better.”

Furthermore, there is a concern that democratizing a board of directors would not actually yield any effective results because board members are required to represent the interests of all shareholders. This further the idea that ideally, a company should work with shareholders and the existing board members as a more cohesive unit instead of postulating and then replacing members representing either party. A more cohesive board can be best achieved by mediation, which may be stipulated in the framework of a company’s bylaws. Whether a board is more or less effective with activist nominated directors remains to be seen given the context, but there is no reason to wait until a company has to be put in the position to consider if board members are loyal to those who helped get them elected.

IV. PROPOSAL

There will always be investors who own substantial stakes in a company, and many times, they will have ideas for how to grow and improve their investment. This creates an ever-present dynamic that will always require some sort of negotiation. Nasty, long, drawn out battles between the two parties cost both sides money, which runs counter to the investor’s ultimate goal. Battles divert corporate executives’ attention from running the company to handling the demands of the investor. Furthermore, these battles are typically very public and can tarnish the reputation of a

126 Horney, supra note 21.
127 Katz & McIntosh, The Unintended Consequences of Proxy Access Elections; Corporate Governance, N.Y.L.J. (2015).
876 CARDOZO J. OF CONFLICT RESOLUTION [Vol. 18:857

company. As such, one clear way to improve the relationship between activist investors and the companies in which they invest is through mediation.

“Before launching an all-out offensive against an activist investor, both sides should consider a middle path.” 128 This middle path may simply be to assess both sides of the coin before responding in an emotional or defensive manner. When investors are presented with an even-keeled voice, it “. . . shows that investors are willing to hear both sides and won’t necessarily always side with the activist, even when there is potentially greater short-term gain to be realized from the activist’s plans.” 129

“[T]he dilemma: A company cannot and should not ignore activists, but it also should not immediately accept or reject their ideas. It must be ready to evaluate the activist’s investment thesis quickly—and then decide where to cooperate, fight or negotiate.” 130 If a company must assess the situation before making a decision, mediation is the perfect forum. Mediation will, at best, create an opportunity for the company and its management or board members to find a middle ground with investors, and, at worst, create a dynamic that is more formalized and prevents the company from becoming a public spectacle. Additionally, this type of forum has the capacity to expedite negotiations since they will be done face-to-face instead of through letters from law firms. Accelerating this process in turn saves the company money because it will be able to return its full attention to running a successful business.

Including a mediation clause in a company’s organization documents is the ideal way to ensure that all investors have a clear process in which to approach companies. This clause should read that a good faith participation in mediation with current management is required. Using the bylaws to codify this process would ensure that this method would be a required first, and hopefully final step.

Many activists—particularly strategic reformers—avoid a hostile approach . . . . In an ideal situation, a company manages these negotiations to a favorable conclusion. Effective leaders start by listening closely to the activist’s concerns, keeping the discussion private whenever possible. They avoid confrontation through careful and thorough negotiation. They aim to reach a

128 Kelly, supra note 41.
129 Horney, supra note 21.
130 Hinkel, et al., supra note 1.
common ground based on solid facts and analysis. This kind of negotiation often ends in a favorable settlement between the company and the activist.131

This defines the aim of all mediation, so the idea to codify it in bylaws would be the first step to ensure this process is followed. Understanding that not all activist investors are the same is a critical reason that a mediation clause would be so beneficial.132 The various types of activist investors require the response of the company to vary without any formal framework. With a formalized process in place, a company would be able to avoid wasting time deciding how to respond to the investor. Instead the company could sit down with the investor to better understand their goals from their own words instead of attempting to interpret the investor’s intent from their actions.

A. Collaboration

The nature of collaboration is to take pieces from multiple perspectives and to move forward with a mutually formed perspective. This can be employed in a corporate setting.

[H]ow executives react plays a big part in how collaborative or hostile a campaign gets. Three in four campaigns start collaboratively, our [McKinsey and Company] research finds, but half of those eventually turn hostile. This suggests that management teams should think as much about how they engage with an activist as whether they accept activist proposals.133

They further suggest that companies develop a response team solely responsible for responding to shareholder proposals.134 The team’s main goals would be to understand the activist’s proposals and develop effective responses that are neither confrontational nor disrespectful.135 Thus, having a streamlined method for responding to shareholders that is codified in company bylaws would ensure that each and every shareholder proposal would be treated

131 See id.
132 See Choi, supra note 56.
134 See id.
135 See id.
fairly and equally. The elements of non-confrontation and respect would help to foster the ideal goal: collaboration.

B. Mediation Clause

That company would determine the structure of a mediation clause in its bylaws. The details would be up to each company to best accommodate its corporate culture and capacity. For example, the company would have to select the type of mediation, such as Facilitative Mediation, where a mediator helps guide the parties toward a mutually agreed upon resolution. In this type of mediation, the mediator would not provide recommendations. Alternatively, the bylaws could require Directive Mediation, where the mediator is more proactive to try and generate creative options.

Depending on the type of mediation, the bylaws would reflect the necessary requirements for the mediator. The mediator should be a person knowledgeable in business who could understand the perspective of both the company and the investor, but if Directive Mediation were employed, the mediator would have to be very well versed in business. Companies could include specific qualifications of a mediator in their bylaws, if they so wished. If the company dealt in a particularly specialized industry, they might want to have a mediator familiar with the lexicon of that industry. All mediators would help reframe the points made by each side, steering parties away from negative language like take over, battle, war, and demand. Instead, this process would utilize words like discuss, consider, and negotiate. As each situation developed, the first point of negotiation and agreement would have to be to agree on a mediator.

C. Procedure of Mediation

The mediation procedure should be codified in the Mediation Clause implemented in the bylaws. First, the shareholder would need to show that he meets certain requirements, like maintaining a certain amount of shares for a given time period. This would qualify the shareholder to invoke the Mediation Clause and have the opportunity to sit down with the board. Then, the investor

\textsuperscript{136} See id.
would have to invoke the Clause to inform the board of directors that he is seeking a request for mediation. Depending on the wording of the Mediation Clause, the shareholder would have to submit a written notification to the company that he would be invoking said Clause. This notice must include background information including facts of the situation, the names of all the people that would be attending the mediation from the shareholders’ side, and their respective titles. This could include multiple representatives. The Mediation Clause could be specific enough to stipulate how many representatives could join based on percentage ownership or just allow for a general meeting of the minds between the company’s board and the investors’ side.\textsuperscript{137} The document would also need to describe the nature of their concerns or interests and what actions they want the company to take. This initial document would allow both parties to come to the table, equally prepared, with no surprises.

The Mediation Clause will need to set out parameters for who the mediator would be. It could include background qualifications such as academic degrees and years of work experience in certain specified sectors. The wording would need to ensure that the mediator would be a very neutral party, ideally not someone who had worked with or for anyone on the executive or management team of the company or for anyone from the investment team. Equally, the stipulations could be for someone less familiar with the sector and simply a seasoned mediator who would ensure that both sides are equally heard and respectful. Here, it would still require the mediator have a “specified level of competence to satisfy reasonable expectations of the parties.”\textsuperscript{138} This would of course be up to the board implementing the new bylaws. If the parties were unable to agree upon a mediator, there would need to be a third party appointed who would select the mediator.\textsuperscript{139} For example, the American Arbitration Association provides Dispute Resolution Services and could be named as that uninterested third party that would select a mediator. The mediator would be required to abide by the Model Standards of Conduct for Mediators as dictated by


\textsuperscript{139} See id.
the American Bar Association. These procedures ensure that the mediator is impartial, has no conflicts of interests, and is committed to providing a service to the best of their ability. “These Standards are designed to serve as fundamental ethical guidelines for persons mediating in all practice contexts. They serve three primary goals: to guide the conduct of mediators; to inform the mediating parties; and to promote public confidence in mediation as a process for resolving disputes.”

It should be stipulated in the bylaws that all parts of a mediation remain private and confidential. No company should have to deal with any media backlash that could affect their stock price by some aspect of a mediation being publicized. All individuals should be required to sign confidentiality agreements to this effect.

The cost of the mediation proceedings is something that a board of directors must consider when drafting a Mediation Clause. They could decide that the company will pay for all costs, that the company will pay for all costs up to a certain amount, that the total amount will be divided between the shareholders interested in invoking the Clause and the company, or that the shareholder will have to incur all costs. This would also parallel the timetable that the mediation would be centered around. The period of mediation could be dictated by a specific length of time, or until each side has formally responded to the other. The point of the mediation would be to bring a solution for shareholders that the company could support, so it would be reasonable that it be a shared cost that would afforded each side ample time.

If a Mediation Clause is incorporated into a company’s bylaws, the company and the shareholder would be required to meet in good faith, as per the stipulations. Much in the same way that it is considered an Unfair Labor Practice for parties to refuse to collectively bargain, “. . . parties are not compelled to reach agreement or make concessions . . .” The same expectations would

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1. Id.
2. Id.
3. See id.
4. See id.
5. See id.
6. See id.
7. See id.
8. See id.
9. Id.
10. See id.
11. See id.
apply here, in that an agreement or concessions would not be re-
quired from the Mediation Clause, but a good faith effort would be
required.

D. The Downside of Mediation

If mediation fails to produce a result that the activist investor
is happy with, little is lost. The investor can still return to the pre-
mediation techniques, wage his battle and see if he can accomplish
all that he set out to. The ideal is that that after mediation, the two
parties have a better understanding of the other’s goals and capaci-
ties so that an all out war is not necessary. The poignant question
is whether a potential delay in time is worth the gamble of finding a
middle ground at an earlier time with saved resources and public
reputation—the hope is yes.

Some argue that any sit down with an activist investor is a bad
idea for the company.150 This mindset implies that companies
should always be on the offensive with activist investors and that
sitting down with them would expose more of their inner workings,
and thus, leave them more vulnerable to bullying.151

V. Conclusion

Using the alternate dispute resolution technique of mediation
as a first method for activist investors to approach companies will
save time and money, and eliminate many of the negative interper-
sonal issues that currently arise. Bullying and defensive stances
currently plague companies with activist investors, which deviate
from both effective management, and from the ultimate goal of
earning returns and expanding net positive companies.

The idea of incorporating mediation clauses into company by-
laws provides the framework for a rational meeting of the minds.
This idea represents a midway stance between opening boards up
to more shareholders as per the proxy access proposal movement
and keeping out more shareholders as the DC Circuit implied
when they refused to require any changes to current boards. This
would be a voluntary bylaw amendment, by companies, to allow

150 See Kelly, supra note 6.
151 Id.
shareholders who meet certain criteria to sit down with the board in a mediation setting to see if common ground can be found before time and money are wasted in proxy battles.