IN DEPTH: Giving back

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The average reimbursement paid by companies to activist investors for proxy solicitation costs increased dramatically last year.

U.S. companies disbursed an average $431,831 to cover activists' campaigning costs in 2018, nearly three times the average in 2017, according to data compiled by *Activist Insight Online*. The growing bill comes as the number of settlements has swelled; as many as 142 settlements were reached in 2018 versus 119 in the prior year.

In part, 2018's increase in costs could be explained by the fact that there were more reimbursements at mid- and large-cap companies, which totaled $10.4 million in 2018 compared to $1.5 million in 2017.

Lawrence Elbaum, co-head of Vinson & Elkins' shareholder activism practice, told *Activist Insight Online* that the increase in costs could also be explained by longer campaigns. Indeed, according to *Activist Insight Online*, it took on average 82 days to settle the differences last year compared to 79 in 2017.

Settlements to proxy fights can involve a lengthy list of items to reassure each side that its interests are protected, and activists have long argued that when the changes they secure benefit all investors, shareholders as a whole should bear the cost. Activists also argue that reimbursements are fair because all shareholders benefit from the engagement.

Yet pushback from companies and institutional investors, as well as the growth of better-resourced activist funds means not all settlements come with a reimbursement clause.

Cost insensitive

Reimbursements are more frequently recorded at small- and micro-cap companies, as activist investors active in this market are typically less well-capitalized. Large activists rarely request reimbursements, although there have been some notable exceptions. Starboard Value was reimbursed in all nine of its publicly announced settlements between 2017 and 2018, receiving in total around $5.75 million from its targets, which include large-cap firm Newell Brands and mid-caps like Mellanox Technologies and Perrigo. Starboard did not respond to a request for comment.

Elliott Management does not typically seek reimbursement, but the settlement with NRG Energy, a company it had targeted together with Bluescape Resources in early 2017, included expense reimbursements of up to $700,000. Third Point Partners was reimbursed by as much as $10 million in its 2014 proxy fight with Sotheby's after litigating a new kind of poison pill, but received nothing following this year's settlement with Campbell Soup even though that fight also landed in court.

"For Third Point, getting a couple of millions back or not, it's a rounding error," Kai Liekefett, a partner at Sidley Austin who leads the firm's shareholder activism practice, told *Activist Insight Online*.

Aneliya Crawford, a partner at law firm Schulte, Roth & Zabel, added in an interview that many well-heeled activists would rather get an additional concession from the company than financial reparations. For others, however, the cost of a campaign could have an impact on the returns available to their investors.

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Better prepared

"For smaller investors, reimbursement may be an incentive to take on the hard fight with a company to get a deal beneficial for all shareholders without having to solely bear all the expenses," Crawford said.

According to *Activist Insight Online*, the average reimbursement sum in small-cap situations nearly tripled this year compared to 2017, in part due to a few outliers. For instance, Sarissa Capital Management's settlement with Innoviva at the beginning of 2018 contained a $2.7 million reimbursement as the engagement lasted nearly 12 months, ten-times higher than the average of $320,000.

Another factor in the drive for costs in the small-cap market is the fact that many activist investors now hire counsel earlier in the process and more resources are deployed, according to Crawford. "It is true from our experience that activists are increasingly better prepared before a launch," she said. "Expenses used to be just fees for a law firm and proxy solicitor in the past and in bigger campaigns a PR firm; now activists invariably hire a PR firm and very often industry experts that add on to the costs."

Tough negotiations

Although settlements are rarely, if ever, canceled over a reimbursement, advisers say negotiations can be testing. "Companies and boards uniformly feel that activists asking for expense reimbursements after a nasty campaign is like adding insult to injury," Liekefett said.

Oftentimes, it is the last topic to be discussed, after the sides come to an agreement on the main issues such as board composition and corporate governance, Crawford noted.

Decisions often rest both on the board's interpretation of what amounts to a reasonable request, and to some extent on the board's relationship with the activist, according to Elbaum.

Some investors that are more amicable in their engagement may be perceived as having a mandate from all shareholders to search for directors and the company may be more "flexible" in providing reimbursements, Elbaum said. In more contested situations, companies will balk – at least initially – and particularly where shareholder support is in doubt, he adds.

Institutional investors are slowly extending their policies to cover the topic, especially in the rare instances they are put up for a shareholder vote, instead of being dealt with privately. BlackRock, the largest asset manager in the world, does not always encourage reimbursements, even in situations where it supports a dissident campaign. In its proxy voting guidelines for 2018, BlackRock said reimbursements "may incentivize disruptive and unnecessary shareholder campaigns." State Street, by contrast, generally supports reimbursements.

With institutions looking on and bigger activists less insistent, companies have every reason to push back. "Companies don't want to be looked at as having purchased a vote or silence from the activists," Elbaum said.

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