

Insights From Two Recent Successful Proxy Contest Defenses

By Spencer D. Klein and Ted Powers

In most recent situations in which activist shareholders have sought board representation, the activist has achieved its objective – either by negotiation and settlement with the issuer or by taking the matter to a vote and winning the support of fellow shareholders.¹ However, in two recent cases – Alere’s defense against Coppersmith Capital Management and Walter Energy’s defense against Audley Capital Advisors – the issuer prevailed. While we are loathe to draw sweeping conclusions from only two situations, and note that every situation is different, there are noteworthy observations to be made:

- *It helps to have fresh, independent, members of the board*
 - In Alere, all four of the board’s nominees were new independent persons (two affiliated with an existing shareholder) and the issuer agreed pre-annual meeting to expand the board post-annual meeting to include one additional new director affiliated with another shareholder. Nine of the eleven board members (including the issuer’s nominees) were independent.
 - In Walter Energy, four of the board members were new in the last two years, and nine of the ten directors were independent.
- *Perceived shareholder-friendly governance initiatives help*
 - Alere had declassified its board the prior year and, after ISS and Glass Lewis recommended against Alere’s slate of director nominees, recommended implementing a lead independent director, majority voting, and the ability of shareholders (holding 25%) to call a special meeting.
 - Walter Energy’s board was already declassified.²
- *If the incumbent board and the activist espouse similar plans for revitalizing the business, deference often goes to the incumbent board, especially when its actions appear to be working*
 - In Alere, Coppersmith ran on a platform that sought to have Alere exit non-core businesses, reduce leverage, and rationalize the expense structure. Alere’s existing board previously announced its plan to reestablish organic revenue growth, simplify the corporate structure, and use cash flow to reduce leverage. Alere’s stock price was up 28% since implementing the new strategy and showed positive financial results in the quarter before the contested election.
 - In Walter Energy, ISS concluded that Audley’s plan was substantially similar to that of the incumbent board and that the plan was showing signs of success. Glass Lewis concluded that the existing board had demonstrated encouraging progress on key issues and it was unclear that a change in oversight was necessary.

¹ Of the 27 situations we’ve been tracking that have reached conclusion, 21 have resulted in board representation for the insurgent shareholder.

² While actions such as declassifying a board and permitting shareholders to call special meetings may help win a proxy contest, this needs to be weighed against the vulnerabilities created by such actions. Again, every situation is different.

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- *Having a poor track record as an activist hurts, and aggressive counterattacks by the issuer can help*
 - Alere's comments on the poor performance of companies at which Coppersmith gained board seats and comments on sexual harassment allegations against one nominee appear to have resonated with shareholders.
 - Walter Energy also directly attacked the activist's nominees, commenting on the "hit-and-run" track record of one nominee and on insider trading charges, lax corporate governance, and lack of experience of other nominees.
- *Shareholders listen to cogent critiques of a dissident's plan*
 - One of the focuses of Coppersmith's plan was the divestiture of Alere's Health Management division (a large portion of which Alere had acquired in 2008 for \$1.2 billion). Alere disagreed with Coppersmith's plan to sell the division, arguing that it was core to Alere's strategy and that any divestiture of a profitable business to pay down low cost debt would be extremely dilutive to earnings. Alere also highlighted that Coppersmith valued the division, but that its plan was to deleverage at all costs to generate a tax loss.
 - Some of the focuses of Audley's plan were to sell or spin off certain assets, raise equity capital, and engage in JVs. Walter Energy disagreed with Audley's plan as the assets Audley sought to have divested did not generate sufficient cash flow to operate as stand-alone entities, issuing any equity or hybrid security would unnecessarily dilute shareholders, and engaging in unnecessary JVs would erode shareholder value.
- *ISS and Glass Lewis recommendations are important, but not necessarily dispositive*
 - Alere won despite ISS and Glass Lewis both recommending in favor of Coppersmith's nominees.

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