

The Legal Intelligencer

A Look at the Emerging Trends in Shareholder Activism

by Katayun I. Jaffari and and Kimberly W. Klayman

Shareholder activism was at the forefront of major corporate events during 2013. Proxy fights at Hess, the Dell takeover, and feuds over capital allocation at Apple substantiate recent observations that there is a growing divide between boards and shareholders. In addition to grabbing headlines, shareholder activism has transformed over the course of 2013 through the use of technology and the adoption of new initiatives. As a result of the extensive activity during 2013, companies and their advisers should consider what notable forms of shareholder activism may proliferate in 2014. This article considers the following three areas: the demands of shareholders for disclosure regarding corporate political spending, the use of social media to rally and recruit shareholders to activist causes, and the potential for new restrictions on proxy advisory firms.

DEMANDS FOR CORPORATE POLITICAL DISCLOSURE

Activist shareholders have recently sought to become more involved in decisions regarding corporate political spending. Although it was considered, the U.S. Securities and Exchange Commission (SEC) did not adopt regulations compelling companies to disclose corporate political spending. Despite the SEC's reluctance to adopt rules, certain shareholders remain committed to encouraging transparency in corporate political spending. Absent SEC regulation, shareholders have had to find alternative means of "forcing" companies to reveal corporate political spending.

Corporate political spending became a prominent issue after the U.S. Supreme Court's 2010 decision in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010). Concerns about corporate political spending increased when it became widely known that corporations were funneling unlimited political expenditures through 501(c)(4) organizations. By funneling money through a 501(c)(4), a corporation can anonymously spend exorbitant sums of corporate capital on political matters without negative publicity or shareholder scrutiny. Shareholder activists responded by proposing political spending disclosure requirements in corporate proxy statements and lobbying for an SEC rule that would mandate disclosures of such political spending. When the SEC failed to implement such a rule, shareholders sought alternative and innovative ways of compelling corporate disclosure.

In January 2013, an institutional shareholder of Qualcomm Inc., a Delaware corporation, filed a suit to compel Qualcomm to disclose its political expenditures using Delaware's books-and-records law. Under Delaware law, shareholders have the right to inspect and copy the corporation's records for "a purpose reasonably related to such [shareholder's] interest as a [shareholder]." This suit was the first time that the books-and-records provision was used to get access to corporate records regarding political spending. In its complaint, the shareholder claimed an economic interest in Qualcomm's political spending records. The shareholder wanted to ensure that the records were "consistent with the objective of enhancing stockholder value" and that the decisions of the board of directors of Qualcomm to spend corporate funds on political activities was consistent with its fiduciary obligations to the corporation.

The Qualcomm suit, which was ultimately settled, marked a victory for shareholder activism on the issue of corporate political spending because it effectively achieved the shareholder's goals of compelling Qualcomm to disclose information about its political spending. Immediately after the settlement, Qualcomm voluntarily disclosed its political spending records and adopted a new corporate disclosure policy that was hailed by transparency advocates "as one of the most complete in the nation." Whether the books-and-records law can be used to compel corporations to disclose political spending remains unclear, but the Qualcomm suit demonstrates the innovative methods to which shareholders are turning to make their impact.

THE USE OF SOCIAL MEDIA BY SHAREHOLDER ACTIVISTS

When Carl C. Icahn opposed the buyout of Dell Inc., he used Twitter to communicate with other Dell shareholders. When he lobbied Apple Inc. for a \$150 billion share buyback, Icahn advertised the negotiation on Twitter. Most recently, Icahn used Twitter to issue public updates on a proxy battle between the Icahn Group and the board of the Swiss company Transocean Ltd. These and other examples of the use of social media have significantly altered the predictability of pending deals and proxy disputes.

A 2013 study by FTI Consulting Inc. showed that 80 percent of institutional investors expect shareholder activists to leverage social media to target companies. Additionally, the interactive nature of social media encourages shareholders to both engage in shareholder activism and galvanize around new causes. Investors are able to participate in corporate disputes and dialogue more quickly and easily through social media. In addition, investors from around the world can now more directly engage in shareholder activism. A report by Citigroup showed that since 2010, shareholder activism campaigns from abroad have increased by roughly 27 percent. The report suggested that the number was probably even higher since many global campaigns are unreported. Citigroup concluded that "what was once primarily an American phenomenon is spreading abroad."

The rise of social media has for some years already affected corporate governance relations as well as transactions, but it is only now beginning to influence shareholder activism and shift the balance of power between shareholders and public companies. This year may be a turning point as shareholder activists integrate social media into internal corporate matters in a more discernible and effective way than ever before. As a result of this shift, public companies should consider seizing "the digital opportunity" more aggressively in future transactions, for purposes of corporate governance and to respond to shareholder activism.

THE ROLE OF PROXY ADVISORY FIRMS

Another phenomenon that may alter shareholder activism in the near future is the SEC's growing scrutiny of proxy advisory firms. In early December, the SEC held a roundtable on proxy advisory firms to address "growing concerns that 'proxy advisory firms may be subject to conflicts of interest or may fail to conduct adequate research and base recommendations on erroneous or incomplete facts.'" The SEC first published

a paper and solicited comments on the effects of proxy advisory firms in 2010. Though it received more than 300 comments at the time, the SEC was silent on the issue until the recent roundtable.

There are only a handful of proxy advisory firms, most prominently Glass, Lewis & Co. and Institutional Shareholder Services (ISS), which consult both shareholders and public companies on corporate governance decisions. These firms have had an influential role on corporate matters, particularly since 2003 when the SEC instituted safe harbors for institutional investors that relied on proxy voting advice from third-party advisory firms.

Studies on the effects of proxy advisory firms have increasingly shown a strong correlation between recommendations of proxy advisory firms and proxy voting. This is no surprise, as institutional investors often delegate the power to cast proxy votes to proxy advisory firms. While some argue that advisory firms offer a useful service, especially to investors without the resources to thoroughly consider each vote, others contend that proxy advisory firms provide inadequate "one-size-fits-all best guesses" to their advisees. In addition to having the authority to cast proxy votes, these firms are often in the position of consulting public companies on how to win proxy disputes. Those who want proxy advisory firms to be better regulated argue that this role by such firms poses a problematic conflict of interest.

Though the SEC has not yet indicated whether it will issue a rule to limit the influence of proxy advisory firms, the roundtable suggests that the SEC is, at least, taking the investment community's concerns more seriously. At the roundtable, the SEC discussed the influence of proxy advisory firms, investors' overreliance on proxy advisory firms, the lack of competition in the proxy advisory industry, and conflicts of interest that pose issues to the industry. SEC Commissioner Michael S. Piwowar explained that the SEC failed to respond to these issues sooner because it was preoccupied with the Dodd-Frank Wall Street Reform and Consumer Protection Act. Though the SEC did not announce specific plans with respect to the proxy advisory firms, this overdue response to growing public debate indicates that the proxy advisory industry may be forced to change in the near future.

PREPARING FOR 2014

In 2013, shareholder activists successfully encouraged corporations to be more transparent about corporate political spending, highlighted the importance of social media in proxy disputes and corporate transactions, and helped revive an old dialogue about the role of proxy advisory firms. Companies and their advisers should be prepared that these 2013 initiatives and forms of shareholder activism will likely have an impact on both the subject matter and processes of shareholder activism in 2014.

Katayun I. Jaffari is a partner in [Ballard Spahr's](#) business and finance department and a member of the securities, life sciences/technology, energy and project finance, and mergers and acquisitions/private equity practice groups. She has experience counseling public and private companies in the areas of corporate governance and securities law and compliance. She can be reached at jaffarik@ballardspahr.com or 215.864.8475.

Kimberly W. Klayman *is an associate in the firm's business and finance department and a member of the securities, investment management, and merger and acquisitions/private equity groups. She can be reached at klaymank@ballardspahr.com or 215.864.8792.*

Reprinted with permission from the January 7, 2014, issue of *The Legal Intelligencer*. © 2014 ALM Media Properties, LLC. Further duplication without permission is prohibited. All rights reserved.