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U.S. M&A Activism

Contributing Firm



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U.S. M&A Activism

Shareholder activism, including activism connected to actual or potential M&A transactions, has been part of the US M&A landscape for over 30 years. However, the last several years have seen a resurgence in M&A activism, with new and aggressive activists rewriting the playbook for M&A activism. The increase in M&A activism in the U.S. is consistent with global trends, with many activists (most conspicuously, Elliott Management) being active in the U.S. as well as globally.

M&A Activism by the Numbers

Overall, activism campaigns in the U.S. were down in 2019 over 2018, mirroring an international trend and returning to something closer to a pre-2018 average. However, within those numbers there was a significant uptake in M&A-focused activism globally. Approximately 47% of all activism campaigns had an M&A-related thesis, up from historic averages of around 35% in prior years. In addition, M&A activism in 2019 was more heavily focused toward larger campaigns, with approximately 60% of the total capital deployed in activism campaigns in 2019 directed at those with an M&A-related thesis.

Key Trends in M&A Activism

Consistent with prior years, M&A activism campaigns in the United States focus on three key themes: “break up the company”, “sell the company”, and “deal-related” campaigns. In 2019, each of these three themes represented approximately one-third of the number of U.S. M&A activism campaigns. In addition, and again consistent with recent years’ experience, the thematic point of many campaigns from the 1980’s and the mid 2000’s of “lever up the company” currently represents only a very small percentage of U.S. M&A activism campaigns.

Reliable data on the success rate for U.S. M&A activism are hard to come by, particularly because of ambiguity as to the definition of “success”. Anecdotally, though, one can see the following:

In the U.S., M&A activists in 2019 had most success in pushing for break-ups of companies or significant divestitures, such as Elliot Management’s campaigns at AT&T and Marathon Petroleum.

In the U.S., M&A activists in 2019 had some success in “sell the company” campaigns, including Icahn’s campaign at Caesars Entertainment. However, Mantle Ridge has, for the moment, settled for board representation at Aramark. In this category, we note that Icahn’s campaign at Hewlett Packard remains open at the time of writing.

In the U.S., M&A activists in 2019 had the least success in attempts to scuttle existing transactions. Under this category, Icahn fell short in its efforts to prevent Occidental Petroleum’s proposed acquisition of Anadarko Petroleum, and Starboard Value failed to block the acquisition by Bristol-Myers Squibb of Celgene.

Notable 2019 M&A Activism Campaigns – “Break Up the Company”

One notable 2019 campaign in the U.S. using the “break up the company” theme was the campaign by Starboard Value at AECOM, the government services provider. AECOM was the result of a number of acquisition transactions over a period of time (most significantly that of URS Corporation in 2014), leading to its ownership of a portfolio of related businesses that were not well integrated. In June 2019, AECOM announced a plan to spin off its Management Services business as a standalone public company, to be effective in the second half of 2020.

Less than one week later, Starboard Value issued a public letter to AECOM in which Starboard disclosed an approximately 4% ownership in AECOM and urged that AECOM undertake a full strategic review, including consideration of the sale of its Construction Services business. In that letter, Starboard indicated some skepticism regarding the proposed spin-off of the Management Services business. The Starboard letter was also notable for its detailed criticism of AECOM for having failed to meet financial targets, including synergy estimates, relating to its acquisitions (most particularly URS) and for the letter’s very pointed comparison of AECOM to a peer company that over the last few years had significantly outperformed AECOM by rationalizing and better integrating acquired businesses.

After a period of confidential discussions between Starboard and AECOM, in October 2019 AECOM announced the cancellation of the proposed spin-off of its Management Services business and, instead, the sale of that business for cash to a consortium of private equity buyers. Analyst commentary at the time suggested AECOM was receiving an attractive valuation for the Management Services business in that sale. However, notwithstanding the sale of the Management Services business, in November 2019 AECOM and Starboard entered into a settlement agreement, with AECOM adding three new independent directors to its board, including a Starboard insider, and separating the roles of the chairman and CEO. In addition, AECOM’s CEO announced his early retirement.

The campaign at AECOM, and its outcome, illustrate a number of themes about M&A activism in the U.S.:

Companies that have grown through a number of acquisitions of related but not integrated businesses are particularly susceptible to “break up the company” campaigns.

Simply selling off one business may not placate an activist investor that is running a “break up the company” campaign, and such an activist may still insist on board representation to ensure adequate board-level commitment to any strategic review process.

Companies that are under-performing relative to peers are more susceptible to activism campaigns. This feature is not limited to M&A activism, however.

Companies whose management teams fail to deliver on projected gains from acquisitions are more susceptible to activist campaigns. Once again, this is not limited to M&A activism.

Another interesting feature of the settlement between AECOM and Starboard was the inclusion in the AECOM’s board of a Starboard insider as one of the three new directors. With respect to

activist campaigns generally in 2019, activists won over 120 board seats in 2019 in the U.S. (both M&A campaigns and other campaigns), with most of those seats secured through negotiated settlements. Both the number of board seats won, and the prevalence of negotiated settlements, were broadly in line with historic practices. Over the longer term, however, there has been a trend toward fewer board seats won by activists being filled with insiders of the relevant activist. This trend has been influenced by strongly stated views from major institutional investors as to their preference for qualified independent directors rather than activist insiders, as well as potential legal issues arising for an activist from having an insider on a company's board of directors. In the activist campaigns at Emerson Electric and Marathon Petroleum, for example (D.E. Shaw and Elliott Management, respectively), the ultimate settlement did not include any activist insider being appointed to the board of directors.

Notable 2019 M&A Activism Campaigns - "Sell the Company"

One notable 2019 M&A activism campaign in the U.S. in the "sell the company" category was the campaign by Mantle Ridge LP at Aramark, the facilities services company. In late May 2019, it was publicly reported that Mantle Ridge was exploring a bid to acquire Aramark. Although this was never publicly confirmed by Mantle Ridge or Aramark, it was corroborated by a number of confidential sources. Mantle Ridge was founded in 2016 by a former Pershing Square Partner and, while it has run several successful activist campaigns (most notably at CSX Corporation), an LBO of Aramark would have been both very large and unusual for Mantle Ridge. In addition, Aramark's substantial existing leverage made a conventional LBO not straightforward. This led some commentators to suggest that Mantle Ridge's "real play" here was to provoke a sale of Aramark to a third party - perhaps one of its strategic competitors.

In August 2019, Mantle Ridge made a Schedule 13D filing with the U.S. Securities and Exchange Commission. In that filing, Mantle Ridge disclosed (a) beneficial ownership of approximately 24 million Aramark shares (representing approximately 9.8% of Aramark), of which approximately 13.6 million shares had been acquired in the preceding two weeks, and (b) economic exposure to another approximately 25 million Aramark shares through cash-settled derivatives, the dates of acquisition of which were not disclosed. Given this disclosure, it seems highly likely that Mantle Ridge already had substantial economic exposure to Aramark shares prior to the publication in May of the reports as to Mantle Ridge's interest in an acquisition. Mantle Ridge's Schedule 13D did not, however, disclose any specific intention with respect to an acquisition of Aramark, leading commentators to suggest that any plans by Mantle Ridge in that direction were (for the moment) dormant.

Within days of the Mantle Ridge 13D filing, the Aramark CEO announced his early retirement.

In early October 2019, Aramark and Mantle Ridge entered into a settlement agreement under which (a) four incumbent Aramark directors resigned immediately, (b) the founder of Mantle Ridge and three new independent directors were appointed to the Aramark board effective immediately, (c) Aramark appointed a new CEO, with a strong historical connection to Mantle Ridge, effective immediately, and (d) a fourth new independent director will be added to the Aramark board at the next Aramark annual meeting. To date, no acquisition of Aramark has been announced.

This campaign illustrates a number of important points regarding U.S. M&A activism:

- In the U.S., a “sell the company” campaign clearly is harder than, for example, in 2005-2006. Boards of directors are not being stampeded into running an auction or selling the company merely by the emergence of a vocal activist.
- Increasing regulatory scrutiny of U.S. M&A is further complicating “sell the company” campaigns. In light of the industry in which Aramark operates, it is likely many domestic and international private equity funds or sovereign wealth funds would not have been interested in participating in an acquisition of the company. In addition, in light of the structure of the industry, it is likely many of Aramark’s domestic competitors would similarly have been unable to participate in any acquisition.
- The use of “toe hold” positions, particularly through cash-settled derivatives, remains an important part of the U.S. M&A activist playbook. This is true notwithstanding the legal difficulties encountered by Pershing Square in connection with its campaign at Allergan (which, coincidentally, occurred while the founder of Mantle Ridge was still at Pershing Square).
- While activists in the U.S. are frequently perceived as “short termists”, a “sell the company” campaign may play out over a substantial period of time.

Notable 2019 M&A Activism Campaigns - “Deal-Related”

Deal-related M&A activism campaigns tend to fall into two categories: on the “target side”, an activist may be seeking an increase in the consideration (“bumpitraging”), an alternative/higher offer or (rarely) the rejection of the transaction in its entirety, while on the “acquirer side” an activist usually is campaigning for the cancellation of the transaction. One of the most notable U.S. M&A activist campaigns in 2019 was in the last category: the campaign by Starboard Value as a shareholder of Bristol-Myers Squibb to block its acquisition of Celgene Corporation.

In early January 2019, BMS announced its proposed acquisition of Celgene for a mix of BMS shares, cash and a contingent value right (CVR). It was one of the largest M&A transactions of 2019, and one of the largest transactions ever in the pharmaceuticals sector. Given the amount of BMS stock to be issued, it also required the approval of the BMS shareholders. The transaction was not well received by BMS’ shareholders, with its share price falling approximately 8% in response to the announcement of the transaction.

In late February, Wellington Management, a major institutional investor with a BMS shareholding of approximately 9%, filed a Schedule 13D disclosing its opposition to the Celgene acquisition. The next day, Starboard Value issued a public letter disclosing that (a) it held approximately 4% of BMS, (b) it was opposed to the Celgene acquisition and (c) it planned to solicit proxies from BMS shareholders “against” the Celgene acquisition. The letter also contained a detailed criticism of the proposed acquisition as well as of the performance of BMS management generally. Neither Wellington nor Starboard indicated they were cooperating with the other with respect to their opposition to the Celgene acquisition.

The BMS shareholder meeting to approve the acquisition was set for April 12. Both BMS and Starboard cleared proxy material through the SEC and commenced soliciting proxies “for” and

“against”, respectively, the Celgene acquisition. In late March, Institutional Shareholder Services and Glass-Lewis both issued recommendations that their clients vote in favor of the acquisition. In response, Starboard announced that it was withdrawing its proxy solicitation, although Starboard reaffirmed that it was still opposed to the Celgene acquisition. At the BMS meeting, the Celgene acquisition was approved, with approximately 76% of the BMS shares present at the meeting voting “for” and 24% voting “against”.

This campaign illustrates several broader points regarding U.S. M&A activism:

- “Acquirer side” M&A activist campaigns face a significant structural hurdle. Because a renegotiated transaction is, in most cases, not available as a practical matter, the activist must make the argument that the proposed transaction is so poor the shareholders are better off with no transaction. As the ISS and Glass-Lewis recommendations showed, that is a hard argument to win.
- Traditional “long only” investors, such as Wellington, are very comfortable being closely aligned with M&A activists, although the legal issues under Sections 13(d) and 16 continue to limit formal cooperation.
- ISS and Glass-Lewis remain very influential. Commentators may debate how strictly their recommendations are followed and by whom, but the BMS vote carried quite comfortably once the “against” votes from Starboard and Wellington are put to one side.

Conclusion

M&A activism has settled in again in the U.S. market, and (much as it was in the late 1980s and the mid-2000s) it is a key component of overall M&A considerations as well as board governance concerns. No doubt that tactics and objectives will shift in subtle ways in the years to come, but at least for the moment it is hard to see why it will become less important, rather than more important, in the 2020s.