I heard a good talk recently about addressing life’s problems, and it included an analogy that I thought was a great illustration of how procrastination usually multiplies problems instead of solving them. The speaker said that she lives near the water, and her family enjoys all the recreational advantages that it offers, including canoeing. She admitted, though, that one threatening aspect of that lifestyle is the reptiles that find their way into her yard. According to the speaker, that threat can often make it pretty scary to turn over a canoe that has not been used for some time, even though her family always looks forward to enjoying the canoes after a long winter. The longer the canoe has been inverted, the scarier it is to turn it over since it is more likely that a snake will be under it and that the snake has grown to a healthy size. The moral of the story, of course, is that our problems are like that snake under the canoe: the longer we wait to address them, the bigger and scarier they become.

This analogy can apply to many aspects in all our lives, but it occurred to me that
shareholder activism is a problem that most definitely grows the longer it is under the canoe. You may be blissfully unaware that an activist shareholder has entered your ranks and is developing a plan to push a specific agenda. Or an activist shareholder may be known to you, but appears to be a passive shareholder with no present intention of aggressive behavior. The longer you refuse to look for and at an activist, and the longer the activist remains unnoticed or ignored, the more time the activist will have to prepare a strategy for influencing the future of your community bank.

An activist shareholder is likely to initially acquire shares in your institution very quietly, and is unlikely to get too active until more like-minded investors become involved to help them win a campaign. Once the activists recruits their swarm of cooperating investors, they then become very aggressive in pushing the bank toward a specific agenda, whether that be the adoption of a certain corporate vision or a sale of the institution on their terms. They do this by creating continued unpleasant havoc for the board of directors until they get their way. If the institution’s board of directors disagrees with the position or vision of the activist, the key is to act quickly in defending the board’s long-term strategy for the bank. Passivity is typically seen as a sign of weakness by these investors, and it will encourage them to continue to build momentum toward seizing control of the institution’s future.

To that end, the first step is to figure out exactly how many potential activists and activist supporters an institution may have in its shareholder ranks in order to see how bad the problem is currently and to develop the best strategy to address it as early as possible. Until an activist is ready to pounce, the tendency is to stay under 5% recorded or beneficial ownership in order to avoid having to file Form 13D with the SEC that would disclose the activist’s stock ownership and intentions. An activist will also often own stock in a “street name” (i.e., through a nominee) as opposed to in their own name, so one way for a publicly traded institution to identify an activist shareholder is to order a non-objecting beneficial owner (NOBO) list that tells the institution more about those investors who have consented to disclosure of their beneficial ownership through third-party custodians.

It is important, though, to acquire this list well in advance of any potential proxy contest initiated by an activist. If the institution waits to order a NOBO list until after the activist challenges the corporation’s board or policies, state corporate law will generally require the corporation to provide a copy of the NOBO list to the activist shareholder as well, handing the activist a pretty significant opportunity to recruit competing votes in a proxy contest. Therefore, if an institution is interested in trying to use a NOBO list to identify a problem before it starts, the time to order such a list is well before a potential activist may spring any plan. Doing so may not only help the institution identify certain shareholders it needs to engage before an activist problem grows, but it also could help the institution avoid having to turn over the list to the activist if a proxy contest arises after the list is no longer “current” for that purpose.

If there aren’t too many potential activists and activist supporters involved when the NOBO list is requested, then the issue may be easier to address; however, since activist investors tend to attract other like-minded investors, the quicker the whole board can act to protect its strategy, the more likely it is to succeed in preventing a
sale or other undesirable result. It is unlikely that your typical community bank will have the necessary resources in house to identify shareholders that may fit into this category, so it may be worth the expense to engage a proxy solicitor at this stage, long before a proxy contest has begun, at least for a limited engagement involving the review of the NOBO list and the identification of any potential covert activist. While proxy solicitors specialize in helping a corporation conduct a proxy fight once the challenge has become public, they also deal enough with activist investors that they are typically experienced in finding those hiding within your shareholder records. Proactively engaging the solicitor may also help the institution develop a strategy with the proxy solicitor of its choosing before that solicitor might be engaged by the activist shareholders to represent them instead.

Once the activist shareholder’s presence is publicly disclosed, which usually is in the form of a public announcement of a disagreement with the institution’s board or management, the activist is typically already prepared for a much bigger fight at the next annual shareholder meeting. At that point, if the institution has not already done so, it will be critically important to take the corporate planning steps mentioned in our last article as quickly as possible. Oftentimes, though, it may be too late once this stage is reached. Any steps taken by the institution following this public announcement that protect the board or management from activist investors could be seen as not honoring fiduciary duties to minority shareholders if those steps appear to be triggered by a minority shareholder complaint. This may mean that the corporation will have no choice but to fight the activist on the activist’s terms or negotiate a resolution that likely will be undesirable. While a corporation may need to be aggressive to be effective in a proxy fight against an activist, caution is warranted once the activist has launched an attack, in order to prevent exposing the board to potential liability.

Therefore, it is always better to turn the canoe over today instead of tomorrow. In order to prepare a thorough analysis of any potential problem, it is helpful for the institution to request a NOBO list immediately and find a proxy solicitor that can help it examine that list, along with its named shareholder list, in order to identify any snake hiding under the canoe. Once the corporation gets a better handle on how many activists and activist supporters may already be invested, it will have a better idea of how aggressively and swiftly the board can expect the activists to act in order to exert authority and force their own agenda. The earlier this is done, the more aggressively the institution generally can react to a growing problem without the threat of liability for retaliatory actions.

© 2021 Jones Walker LLP

National Law Review, Volume XI, Number 301

Source URL: https://www.natlawreview.com/article/what-s-under-canoe