

THE VIEW FROM NEW YORK : COPING WITH HEDGE FUND ACTIVISM

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Every decade needs a villain. In the 1980s it was corporate raiders. In the 1990s it was corporate executives. And in the 2000s, it appears to be the activist hedge funds.

David A. Katz, socio de Watchtell, Lipton, Rosen & Katz en Nueva York, afirma que actualmente hay muchos activistas de los Fondos de Inversión Libre (o hedge funds). Sus métodos son altamente sofisticados, suele tratarse de grupos influyentes y de elevado poder adquisitivo, por lo que supone una amenaza importante para la valoración y los planes a largo plazo de una empresa. David Katz apunta que el estar preparado y tener capacidad de respuesta, en caso de ataques por parte de activistas de los fondos de inversión libre, es una responsabilidad adyacente al papel directivo y gerente de toda empresa. Highly sophisticated, well-connected and heavily financed – over \$1.2 trillion by some estimates – hedge fund activists pose a serious challenge for many companies pursuing plans for long-term value

In a notable change from the more capricious institutional investors, that often focused on corporate governance as an end in itself, today's hedge fund activists have the ability to put forth sophisticated presentations of their strategy for a target company and, as a result, attract other shareholders to follow their lead.

The trend has received significant press coverage, in part because of the amount of money involved and in part because of the high profile of some of the targets, such as McDonalds, Wendys, Heinz and Time Warner.

The activist hedge funds need to be differentiated from the "hedge funds" that a company ought to view as friendly, longterm investors that appear to be genuinely committed to value creation for all shareholders over a significant period of time (as opposed to short-term speculators).

Hedge funds are facing increasing regulation due, in part, to their activist activities. The influence and tactics of hedge fund activists in Europe in high profile situations, such as the Deutsche Börse AG and VNU NV, have prompted efforts to increase disclosure obligations and consider other regulations in order to make it more difficult for activist hedge funds to work together.

Experience to date has shown that operational and share price performance do not themselves guarantee safety. Even size is not an effective barrier, as hedge fund attacks do not always involve takeovers, but, in many cases, they involve proxy fights to gain board representation and push for strategic change.



The vulnerability of a company depends as well upon the state of its structural and other corporate defences. There has been a significant trend in companies' eliminating takeover defences, such as staggered boards and shareholder rights' plans, in order to increase their corporate governance ratings. Companies must now consider the longterm effect of dropping their defences before sacrificing them for a corporate governance rating boost of questionable value.

Preparing and responding to attacks by activist hedge funds is a serious responsibility of management in today's environment. When done properly it is a process that is time-consuming, labourintensive and ongoing. And it requires much advance preparation.

A company must be able to respond quickly and thoroughly, ideally, by understanding the various alternatives that activists are likely to propose – such as spinoffs, share buybacks, special dividends, or a sale of the company – and have detailed answers as to why the company's current strategy is superior.

Similarly, companies must follow analysts' reports carefully and be prepared to respond to proposals or suggestions made by analysts as quickly as possible, as they are often the catalyst for investments by the activist hedge funds. Another element is the proactive communication of a company's message and strategy.

I believe that preparing for potential hedge fund activists can, in itself, be a healthy process for a company with substantial benefits. Ideally, management will take valuable time to carefully review strategic options and to renew their focus on important aspects of corporate governance such as improving communications with the board of directors and major shareholders while closely watching analysts' reports and changes in shareholder composition.

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