

Landmark Win for Activist Shareholder— Some Lessons for Boards and Managements

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On October 10, 2014, the shareholders of Darden Restaurants Inc. ("Darden") removed all 12 of Darden's incumbent directors and elected an entirely new slate of directors nominated by Starboard Value LP ("Starboard"), an activist hedge fund. Starboard's sweeping victory was a stinging defeat for the incumbent board of directors and management of Darden.

This victory followed a contentious public campaign and a proxy fight. In brief, in late 2013, in response to pressure and criticism from activists regarding Darden's perceived underperformance, particularly of its Olive Garden and Red Lobster businesses, Darden announced a plan to spin-off or sell its Red Lobster business. Starboard believed that the Red Lobster separation would destroy substantial shareholder value and rallied majority shareholder support for a special meeting to provide shareholders with a forum for expressing their views on the proposed Red Lobster separation. Although a majority of the shareholders of Darden had consented to holding a special meeting, Darden's board further infuriated Starboard and other shareholders by agreeing to sell the Red Lobster business to Golden Gate Capital for \$2.1 billion prior to the special meeting being held.

Starboard then publicly condemned Darden's board for what it characterized as ignoring the special meeting request and agreeing to sell the Red Lobster business in a value-destroying transaction and nominated 12 director candidates for election at Darden's annual meeting. Darden's board attempted to diffuse Starboard's request that an entirely new board be

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elected by announcing that Clarence Otis, Jr. was stepping down as Darden's Chairman and Chief Executive Officer and that Darden would run a reduced slate of nine director nominees for 12 seats at the annual meeting. Instead of accepting these concessions, Starboard continued with its proxy fight for control of Darden's entire board and published a 294 page "whitepaper" that was highly critical of Darden's board, management, and business operations.

Influential proxy advisors Institutional Shareholder Services and Glass Lewis, who have frequently supported short slates of directors nominated by activists in the past, took the unusual step of recommending that shareholders vote in favor of Starboard's full slate of nominees. This, among other factors, caused Darden's shareholders to lose faith in the judgment of the incumbent directors and the direction management was taking their company, and ultimately contributed significantly to Starboard successfully electing its full slate of nominees to Darden's board.

Starboard's Victory — Some Lessons for Managements and Boards

Starboard's victory is likely to embolden it and other activists to be even more aggressive when making demands of boards and managements in the future. In the current economic environment, it is more important than ever that boards of public companies take steps to avoid having their companies "put in play" by activists. The following are some steps that boards should consider to lessen the likelihood that their companies will be put in play:

- Routinely monitor and review the company's strategy, capital allocation, and businesses in light of potential activist arguments for spinoffs, share buybacks, increased leverage, special dividends, a sale of the company or business unit, or other fundamental changes.
- Regularly engage in meetings with institutional shareholders to seek open and honest feedback regarding the company's direction. These meetings should ideally include independent directors.
- Maintain a unified consensus on key strategic issues, and otherwise assure that vigorous and open boardroom debates over business strategy, direction, and other matters remain within the boardroom.
- Periodically schedule presentations by counsel and/or investment bankers to familiarize themselves with the then-current activist environment as well as the direction of the financial markets.

While taking steps to lessen the likelihood that their companies will be put in play, boards should also proactively plan for the possibility that their companies will be put in play. The following are some steps that boards should consider to be prepared for an activist attack:

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- Create a core response team consisting of a small group of key executives (*e.g.*, chief executive officer, chief financial officer, general counsel, investor relations officer) plus advisors, including legal counsel, financial advisors, proxy solicitor, and a public relations firm that is ready to quickly respond to any activist attack.
- Review the company's structural defenses and defensive profile to determine what, if any, steps can be taken to make the company less susceptible to an activist attack.
- Work with legal counsel to prepare a shareholders rights plan that can quickly be adopted by the board if the need arises because of an activist attack.

Note that these actions should be taken with a view to preserve and maximize the board's and management's flexibility in responding to any activist attacks and permitting the board and management to act in the shareholders' best interests. This is important because any actions that are perceived by the shareholders, proxy-advisory services, and other market participants as further entrenching the board and management are likely to cause more consternation among such participants, and may even prompt an activist attack.

Conclusions

Though Starboard's success in electing its entire slate of directors to Darden's board was unprecedented, it is clear that the facts and circumstances of this proxy fight were unique. Darden's shareholders lost faith in the incumbent directors and management because of, in no small part, how the controversial Red Lobster sale and request for a special meeting were handled by the directors and management. Nonetheless, Starboard's victory underscores the need for boards and managements to remain ever vigilant in executing and communicating sound business strategies to avoid potential attacks by activists.

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