Top 10 Topics for Directors in 2018: Shareholder activism

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With the recent "relative" stabilization of the price of oil has come an increased emphasis by prominent investors on different themes from challenging transactions (see EQT Corporation's acquisition of Rice Energy, Inc.) and corporate strategy to traditional corporate governance concerns. One of the most ubiquitous of these concerns is board composition; shareholder activists are even more insistent on independence and director turnover than they have been in past years. As a result, companies in the energy sector should consider these points themselves before an investor raises them in order to avoid campaigns.

In particular, the days of staggered boards seem to be numbered. According to the *2017 Board Practices Study* published by Institutional Shareholder Services, approximately 65 percent of S&P 1500 companies and 90 percent of S&P 500 companies now hold annual elections for all directors. Statistics such as these make energy companies with staggered boards an attractive governance target for shareholder activists. Additionally, energy companies with long-term directors and relatively little director turnover can indicate entrenchment to an increasingly sensitive institutional investor base.

Other corporate governance themes of activists include composition of management; related-party transactions; compensation; and, as previously discussed, CSR, which can include addressing the horizontal drilling and hydraulic fracturing concerns of environmentalists. As we noted in last year's Top 10 alert, a board needs to be prepared to understand, communicate and respond to shareholder activist concerns. Shareholder rights plans and takeover defenses, including staggered boards, can give the board thoughtful time to analyze and respond to a hostile approach. In the energy industry, shareholder rights plans have been implemented to potentially preserve a company's usable tax net operating loss carryforwards by deterring an ownership change under the Internal Revenue Code.

Energy companies can avoid costly campaigns and increased investor scrutiny by becoming governance leaders and taking such factors into advisement. The board's fiduciary duty run to all stockholders not just proposals by activists. While un-staggering a board or changing bylaws may not always be prudent, allowing some new blood in the boardroom can satisfy an investor base and provide new perspectives and opportunities for the company. The board, however must be mindful of its duties of care and loyalty with a careful deliberation in reaching its decision.

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