Clash Over Darden Board Will Be Measure of Activist Clout

Wall Street Journal
By David Benoit
May 22, 2014

Hedge Fund Starboard Wants to Replace All 12 Directors

An activist investor's uncommon maneuver to overthrow the entire board of Darden Restaurants Inc. will test shareholders' appetite for aggressive action by dissident hedge funds.

On Thursday, Starboard Value LP said it would nominate its own candidates to replace all 12 directors from the board of Darden, which owns Red Lobster, Olive Garden and other chains.

A New York-based hedge fund, Starboard has taken a 6.2% stake in Darden and has been agitating since December to break the company into three parts. Fund executives were livid last week when Darden announced a stand-alone sale of Red Lobster, foiling Starboard's plans.

Darden criticized Starboard's pursuit of a board coup, saying the fund was "seeking effective control" of the company without offering other shareholders a premium.

Starboard's push is the latest sign that activist investors, who buy minority stakes and agitate for corporate change, are looking to wield more power. It comes as activist firms—which have grown in size, number and influence in the past few years—are targeting bigger companies and more-easily gaining entree into boardrooms.

While an activist campaign to take over the entire board isn't unheard of, it is unusual, especially for a relatively large company such as Orlando, Fla.-based Darden.

Only about 20% of the 520 proxy fights since 2008 have attempted to replace the entire board, according to data provider FactSet SharkWatch.

"This is going to be an interesting test case," said Christopher Davis, head of deals and shareholder activism at Kleinberg, Kaplan, Wolff & Cohen PC. Traditionally, "you go for the best-quality minority slate you can get. This suggests this is going to be a very different fight."

Fights for at least a majority of the seats, including full control, increased to about 42% of all proxy fights announced in 2013 and 2012, exceeding the prior four years, according to FactSet data. This year has started off with 35% of campaigns going for control, the data provider said. Often, these shareholder fights are announced in the fall, targeting the following spring annual-meeting season that hits its apex around this time.

Earlier this year, shareholders of real-estate investment trust Commonwealth REIT sided with dissidents Corvex Management LP and Related Fund Management LLC and removed the entire board of Commonwealth.

Last year saw hospital chain Health Management Associates Inc.'s entire board thrown out in a campaign led by investor Glenview Capital Management LLC. Sometimes, the results are mixed when activists win. HMA's new board did just what the kicked-out board had planned and sold the company.

Starboard ran for a majority of Tessera Technologies Inc.'s board last year, when it put up six nominees for an eight-person board. The hedge fund ultimately settled the fight by putting its six nominees on an expanded 10-person board.

Darden, however, with a $6.5 billion market capitalization, is about twice the size of any of those companies. Darden shares rose 1.7% to $49.51 on Thursday.

Andrew Freedman, a lawyer for Starboard, said his client didn't believe minority board representation would be adequate to achieve the change it seeks. "There are always going to be outliers, and those outliers are going to be ripe for judgment," he said.

Going for a majority or all the board seats can bring extra scrutiny and costs to an activist, who has to find qualified, willing candidates and often pay them.

Also, the activist has to convince other shareholders and the influential proxy-advisory firms that it deserves control of a board, without a controlling stake. To succeed, activists typically are expected to present an operational plan for the future and then show why it is better than the board's plan.

A campaign for a minority slate is easier to run and win, advisers say.

"Your goal is to be able to get a foothold on the board and not to spend a lot of money but wield some power," said Keith Gottfried, partner at Alston & Bird LLP in Washington. "If you are going for control, you have to have a plan."

But there are reasons the uphill fight has flattened.

For one, the vast majority of big companies now put all their directors up for annual election, as opposed to staggering their board members across multiple-year terms.

In 2000, 300 of the S&P 500 had so-called staggered boards, but, heading into 2014, only 60 did.

And activists generally are finding stronger board candidates, advisers on both sides say. Still, few expect the pursuit of majority or full control to become the norm.

Harvard Law Prof. Lucian Bebchuk, who has led the campaign for annual elections, arguing it improved accountability in many companies, said he doesn't expect many fights for full control, as institutional shareholders "have displayed considerable reluctance to awarding a majority of board seats to a dissident group."