OVERVIEW OF SHAREHOLDER ACTIVISM
Key Trends in Shareholder Activism

- Significant growth in capital allocated to activist funds

- Increasingly sophisticated campaigns that attract strong media interest
  - Activists are issuing white papers, hiring experienced advisors, nominating highly qualified director nominees and reaching out to other shareholders in advance of a contest

- Increasing numbers of “Son of Activist” funds led by former protégés of well-known activists such as Carl Icahn or Bill Ackman

- Growing support from institutional investors
Support from Institutional Investors

- Historically institutional investors were assumed to be “passive” and to follow recommendations of proxy advisory firms

- Asset managers face pressure to be seen as good stewards for client investments
  - Some invest directly in activist hedge funds or track activist’s investments
  - Activist hedge funds have day-to-day dialogue with portfolio managers and governance teams at institutional investors on investments and potential investments
  - Private support for activists seen at ballot box; public support shown through comments in financial media and (occasionally) participating in campaigns
  - Some have even initiated activism by encouraging activists to launch campaigns at underperforming companies in their portfolios
Teaming Up With Other Shareholders

- Activists are increasingly teaming up with other types of shareholders
- Can occur when activists agree to form a group to increase their leverage on a company, but can also be less formal than that
  - In many cases, a single activist will initiate a campaign, and one or more other activists will join the fray
- Activists are also joining forces with other types of shareholders
  - Last year, California State Teachers’ Retirement System (CalSTRS) joined Relational Investors in a shareholder proposal urging The Timken Company to spin off its steel business
  - Recently, CalSTRS sent a letter to a senior PepsiCo director, asking the company to give Trian Partners’ Nelson Peltz a seat on its board after months of PepsiCo’s resistance to Peltz’s campaign to split its snacks and beverages businesses
  - Pershing Square Capital Management has charted new territory by partnering with Valeant Pharmaceuticals, a corporate acquiror, in an unsolicited bid for Allergan
- Whether these practices will become more common remains to be seen
## Notable Activist Campaigns

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<th>Companies</th>
<th>Dates</th>
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<td>Corvex</td>
<td>Williams, Commonwealth REIT, ADT</td>
<td>12/16/2013, 12/3/2013, 12/19/2012</td>
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<tr>
<td>Third Point</td>
<td>Dow, Sotheby's, Sony, Yahoo!</td>
<td>1/21/2014, 8/26/2013, 5/14/2013, 9/8/2011</td>
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<tr>
<td>Trian</td>
<td>QuPint, PepsiCo, Lazard</td>
<td>8/13/2013, 3/22/2013, 6/18/2012</td>
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## Types of Campaigns

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<th>Goal</th>
<th>Select Recent Examples</th>
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<td><strong>M&amp;A</strong></td>
<td><strong>Sale of Company</strong></td>
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<td>Underperforming Companies</td>
<td>Change in Management / Board / Structure</td>
<td>Change in Operations / Business Strategy</td>
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<td>Businesses with Divestible or Non-Core Assets</td>
<td>Divestitures / Break-Up</td>
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<td>Capital Structure</td>
<td><strong>Balance Sheet Capacity / Cash-Rich Situations</strong></td>
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### Operational

- **Potential M&A Target**
  - Carl Icahn / Oshkosh Corp.
  - Carl Icahn / CVR Energy
  - Elliott / BMC Software
  - Carl Icahn / Clorox
  - Elliott / Actelion
  - Carl Icahn / Mentor Graphics
  - Carl Icahn / Genzyme
  - Carl Icahn / Biogen Idec

- **Underperforming Companies**
  - Pershing Square / Procter & Gamble
  - Third Point / Yahoo!
  - Pershing Square / Canadian Pacific

- **Businesses with Divestible or Non-Core Assets**
  - JANA / McGraw Hill
  - Relational / L-3
  - JANA / El Paso
  - ValueAct / Sara Lee
  - Pershing Square / Fortune Brands
  - Carl Icahn / Motorola
  - Ramius / SeaChange

- **Capital Structure**
  - Elliott / Iron Mountain
  - Relational + JANA / Charles River Labs
  - Carl Icahn / Transocean
  - Relational / Home Depot

- **Balance Sheet Capacity / Cash-Rich Situations**
  - Elliott / Iron Mountain
  - Relational + JANA / Charles River Labs
  - Carl Icahn / Transocean
  - Relational / Home Depot

### Select Recent Examples

- **M&A**
  - Trian / Family Dollar
  - Ramius / Luby’s
  - Elliott / Compware
  - Value Act / Gardner Denver
  - Elliott / Riverbed
  - Pershing Square / Allergan
  - Jana / PetSmart

- **Operational**
  - Carl Icahn / Forest Labs
  - Starboard / Regis Corporation
  - Carl Icahn / Genzyme
  - Carl Icahn / Nuance
  - Third Point / Sotheby’s

- **Businesses with Divestible or Non-Core Assets**
  - Pershing Square / Target
  - Third Point / Sony
  - Barington Capital / Darden Restaurants
  - Carl Icahn / eBay
  - Trian / PepsiCo
  - Relational / Manitowoc
  - Elliott / EMC

- **Capital Structure**
  - Carl Icahn / JANA / SAC / Time Warner
  - Carl Icahn / Apple
Growing Attention on Larger Companies

- The percentage of targeted companies with > $1 billion market cap has increased steadily in campaigns to maximize shareholder value or obtain board seats

- No company is too big
  - The number of targeted companies with > $10 billion market cap increased from 23 in 2012 to 43 in 2013
  - Activists can be successful at large-cap companies despite holding less than 1%

Source: SharkRepellent; The Activist Investor
Sophisticated Campaigns

- Historically the activist agenda was often event-driven and short-term (sale, break-up, dividend or share repurchase)
  - Hedge fund activists frequently compared to 1980’s corporate raiders
  - Use of derivatives contributed to the view that hedge funds were not aligned with other investors
- Today’s shareholder activists are increasingly focused on:
  - Strategy/operational improvements
  - Capital allocation
  - Board composition
  - Management changes
  - Corporate governance
  - Executive compensation
- Now often viewed as a representative voice for all shareholders:
  “It was not long ago that the ‘activist’ moniker had a distinctively negative connotation. It was a term equated with the generally frowned-upon practice of taking an ownership position to influence a company for short-term gain...today, there is widespread acceptance of many of the policy changes that so-called ‘activists’ are seeking to effect.”
  —SEC Chair Mary Jo White, Dec. 2013
- Nevertheless, activist campaigns may adversely affect other stakeholders:
  “Activism is rarely good news for creditors.”
  —Moody’s Investors Service, Mar. 2014
What Makes a Company a Target?

Financial Vulnerabilities

- Parts are worth more than the whole
- Overcapitalized (i.e., excess cash on the balance sheet) or underleveraged companies
- P/E ratio lower than peers
- Poor stock performance relative to peers
- Underperformance of specific business segments
- Non-core businesses or assets that can be divested
- Pursuing significant capital investment plans

Governance Vulnerabilities

- Perceived management/board “chaos”
- A board that lacks either independence or certain competencies (i.e., no directors with significant experience in the company's industry, the lack of an independent chairperson, a board with significantly higher average length of service than peers)
- Governance provisions that favor management and the board vis-à-vis shareholders (i.e., supermajority voting to amend bylaws, classified board membership, restrictions against shareholders calling special meetings or acting by written consent)
- Executive and/or director compensation significantly higher than peers
- Any activities atypical for public company
MANAGING ACTIVISM
Join the Conversation

• Level of shareholder engagement at U.S. public companies varies greatly but trends clearly favor more frequent and meaningful interactions
  • Traditional interactions: annual shareholder meeting, press releases, SEC filings, quarterly results calls, analyst conferences, investor days
  • New focus on one-on-one, year-round outreach to major institutional investors
    • Risks under Regulation FD can be managed
• Key goals and opportunities:
  • Communicate strategic plan and strong governance
  • Understand investor perspectives on performance, strategy and governance and consider changes as appropriate
  • Determine how specific shareholders make voting and investment decisions
    • E.g., voting policies, interaction between governance teams and portfolio managers
    • Disintermediate proxy advisory firms
Customize Shareholder Engagement Strategy

- There is no single strategy for shareholder engagement
- Offer periodic meetings with large institutional investors
  - Meet with governance/proxy voting department as well as portfolio manager
  - Suggest meetings outside of proxy season; use phone calls to continue relationship in between meetings
  - Some institutional investors have limited resources and may not make time unless they have a specific concern
- Who should participate?
  - Meeting with portfolio managers → CEO, CFO, head of IR
  - Meeting with governance staff → General Counsel/Secretary, head of IR
  - Outside advisors should generally not attend (counsel, compensation consultants)
- When should directors participate?
  - Some governance organizations encourage directors to take a leading role
Assess Vulnerability and Involve the Board

- Evaluate the company’s vulnerabilities from an activist’s perspective
  - How does performance compare to peers? Are there alternative financial or business strategies that could be pursued?

**Company Characteristic**

- High cash balance/low debt
- Non-core assets/separate business lines
- Potential M&A target
- Underperformance*

**Activist Campaign**

- Return cash via dividends or buybacks
- Divest or break-up (e.g., spinoff)
- Sale of company
- Changes in operations, strategy, board or management team

* In 2013, the companies targeted by an activist campaign had underperformed the Russell 3000 during the 1-year and 3-year period preceding the activist campaign by 22% and 41%, respectively.

- Are there governance practices that could attract attention?
  - Structural defenses that most peers have dismantled
  - Shareholder proposals that received strong support but have not been implemented
  - Board composition

Source: SharkRepellent
Assess Situation from Shareholder’s Perspective

- Evaluate the Company’s investor relations and communications from a shareholder’s perspective
  - Do shareholders understand the Company’s strategic plan?
  - Does the Company understand the current views of its key shareholders on performance, strategy and governance?
  - Do shareholders see the Company as open and responsive to considering these views?

- Update the Board on the Company’s self-assessment
  - Company should be able to respond to an activist campaign by explaining that it:
    1. Already considered the activist’s proposed action, and
    2. Rejected it in favor of the Company’s strategic plan/existing governance structure for articulable reasons
Plan in Advance

- Critical to research previous campaigns and anticipate next steps
  - Not all activists are the same, and it is important to understand the particular activist’s modus operandi

- Taking the “high road” is critical in responding to an activist campaign
  - Company should be prepared to meet with activist investors when appropriate and to consider constructive proposals
  - Engaging with an activist investor should be very similar to other shareholder engagement:
    - Communicate strategic plan and strong governance
    - Understand investor’s perspective on performance, strategy and governance
Plan in Advance (cont’d)

• Basic steps (similar to preparing for a hostile bid)
  • Maintain a “stock watch” program to detect accumulations of shares as early as possible
  • Monitor non-traditional investor forums (presentations at investor conferences, investment letters to limited partners)
  • Assemble internal team and external advisors and assign roles to ensure that the Company speaks with one voice
  • Prepare communications that address criticisms by an activist and articulate the Company’s short-term and long-term strategic plan

• Who should engage with activists?
  • In general, the CEO should lead meetings with activists and should act as the designated point of contact
  • If an activist requests to meet with directors without management, and if the Company agrees, the designated directors should use the meeting to listen and revert back to the board for consideration
    • Preference is for outside directors, together with management, to meet with activists and, if appropriate, offer the opportunity to meet without management during the course of discussions
PROXY CONTEST
CONSIDERATIONS
Overview of Proxy Contests

• A proxy contest is a contested shareholder vote over one or more Board seats and/or shareholder proposals—with the Company having one position and the dissident shareholder having a different, contrary position

• Proxy contests tend to be very public and highly visible—and can be very heated and include personal attacks
  – Can be distracting, annoying, unnerving and expensive
    • Often requires significant time and attention by senior management and the Board
  – Represents a public challenge to directors’ stewardship of the Company

• Battle is waged on multiple fronts with multiple audiences
  – Proxy statement, “fight” letters, newspaper ads, interviews, one-on-one meetings with investors, meetings with proxy advisory firms, possible litigation
  – Shareholders (retail, institutional, hedge funds, etc.), proxy advisory firms, analysts, media, SEC, federal and state courts

• Each proxy contest is unique
Overview of Proxy Contests (cont’d)

• In any proxy contest, it is *critical* to (1) develop and deliver a clear, consistent message and (2) understand your audience in shaping your message
  – Communications will be heavily scrutinized
  – Similar to a political campaign

• Important to establish and maintain credibility
  – Credibility will not necessarily win a proxy contest, but a lack of credibility can quickly lose one
  – Make decisions based on an open-minded attitude and an informed process

• An activist may seek to elect directors at the 2015 Annual Meeting, or possibly through action by written consent
  – If not a control contest, some shareholders may be more inclined to support a dissident slate
  – Activist would face hurdle of significant insider/family ownership

• Settlement of contest may occur at any time
Institutional Shareholder Services (ISS)

- Leading proxy advisory firm with over 1,200 clients

- Many institutions vote according to, or are influenced by, ISS recommendations

- Can frequently influence 20-30% of the vote

- ISS often favors dissident slates in non-control contests absent a compelling justification in favor of the Company’s nominees
  - Dissidents may be seen as bringing a “fresh perspective” to the Board

- ISS will consider:
  - Have the dissidents proved that board change is warranted?
  - If so, are the dissident board nominees likely to effect positive change (i.e., maximize long-term shareholder value)?
Growing Dissident Success in Proxy Contests

- In fights that “go the distance,” dissidents are winning more frequently
  - Activist “victories” include instances where activists only nominate a “short-slate” of directors, as opposed to a contest to replace the entire board of the company

**Fights That Went The Distance**

<table>
<thead>
<tr>
<th>Year</th>
<th>Dissident (or split) Victory</th>
<th>Mgmt Victory</th>
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<tbody>
<tr>
<td>2010</td>
<td>35%</td>
<td>65%</td>
</tr>
<tr>
<td>2011</td>
<td>44%</td>
<td>56%</td>
</tr>
<tr>
<td>2012</td>
<td>46%</td>
<td>54%</td>
</tr>
<tr>
<td>2013</td>
<td>60%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: SharkRepellent
2014 US Proxy Contests Through June

• The first half of 2014 confirmed the recent trend of dissidents winning a majority of US proxy contests:

Source: ISS Data
Duties and Responsibilities of Directors

- Unless the directors conclude that it would be in the best interests of the Company to do so, the directors do not have any obligation to abandon the Company’s business plan and undertake any actions that emphasize short-term interests
  - Board is not obligated to react to general pressure from shareholders to focus on such interests
  - As the Delaware Supreme Court observed in the Paramount case:
    “The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. . . . Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.”

- The threat of a proxy contest should not be viewed as a sufficient basis for the Board to abandon its existing short- and long-term plans
- It is for the Board alone to determine what action is in the best interests of the Company and its shareholders, and Delaware law on this point is clear and unequivocal:
  “The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.” (DGCL § 141(a))
Duties and Responsibilities (cont’d)

• A director’s decision as to whether or not to undertake a particular action should be based on the totality of the information available and not solely in response to the demands of a particular shareholder
  – Although a director should inform himself or herself about and fully understand requests received from shareholders, he or she is under no duty to implement those requests if they conflict with his or her reasoned, informed judgment as to the right course of action

• There is no road map of specific steps to be followed or factors to be considered by the Board when faced with a shareholder request to pursue a particular course of action

• However, the fundamental rules of the road are straightforward; directors should:
  – Be informed, well-advised and well-motivated
  – Understand alternative courses of action
  – Take their time
  – Act on a basis they honestly believe to be in the best interests of the Company
Short Slate

• An activist may, but need not, use the “short slate” rule
  – The “short slate” rule permits a dissident who is not seeking a majority of the Board to afford shareholders the opportunity to exercise their full shareholder franchise and to vote for a full slate of candidates by “rounding out” its slate with certain of the Company’s nominees

• Mechanics of a Short Slate Contest
  – On its proxy, the dissident would identify the Company nominees that it will not vote for (that is, it will “target” certain Company nominees for replacement)
  – A vote on the dissident’s proxy card would be a vote for its nominees and for the non-targeted Company nominees
  – In effect, the non-targeted Company nominees are included on the Company’s slate and the dissident’s slate and, therefore, run unopposed
Shareholder Communication

- Proxy contest will put the Company under increased scrutiny from investors and the public
  - Strategies and statements will be challenged; directors and management may face public criticism
- Need for high-level executive and Board involvement, both in formation of messages and communication
- Effective, coordinated communication with shareholders is key
  - Roadshows / one-on-ones—contacting investors and sell-side analysts on an individual basis
  - Meet with proxy advisory firms—attempt to win their support; individual directors will be asked to engage with proxy advisory firms
  - Fight letters—letters to shareholders with additional proxy cards
  - Newspaper ads—wide reaching but expensive
  - Retail solicitation—maximizing the voting power of non-professional investors through fight letters and telephone calls
  - Press releases / Ads / Websites / Blogs and Social Media—alternative methods to create visibility and reach shareholders
Roles and Responsibilities

• Proxy solicitor: “eyes and ears” on Wall Street
  – Provide voting analysis based on shareholder composition
  – Coordinate and participate in meetings with institutional investors and proxy advisory firms
  – Facilitate mailing and dissemination of proxy materials
  – Monitor voting and identify voting by institutional investors

• Legal counsel: coordinate activities of team members
  – Assist in preparation of proxy materials (including proxy statement) and clearance by SEC
  – Work with other advisors and Company on proper messaging
  – Review communications for compliance with proxy rules

• Public relations firm: advise on messaging
  – Prepare “fight” letters, ads, messaging to constituencies; advise on strategy

• Investment banker: help articulate strategy
  – Identify financial arguments likely to be made by activist and help formulate response
  – Assist in preparation of presentations to institutional investors and financial community
  – Review financial aspects of proposals made by activist
Settlement Considerations

• Can be easier to settle before a proxy fight becomes public and there has been an escalation of attacks

• Settlement provides a dissident with less of a mandate than if the dissident is victorious in a contest
  – A director joining the Board pursuant to a settlement has not been chosen by shareholders and cannot be said to be advancing a strategy that shareholders have endorsed

• Provides the Board some opportunity to steer the selection of any new director(s) (e.g., nominees acceptable to both the Company and the dissident)

• Settlement considerations
  – Requires sustained, high-level executive involvement over the entire course of the contest
  – Proxy contests can be expensive and very time-consuming
  – Board and management under increased scrutiny from investors and the public
  – Likelihood of another activist shareholder surfacing
  – Likelihood of success (based on ISS recommendation and likely shareholder voting patterns) and number of Board seats at risk

• Settlement can occur at any time prior to the annual meeting, but the “price” of settlement (i.e., number of Board seats) may go up as shareholder preferences are learned
Brian V. Breheny concentrates his practice in the areas of mergers and acquisitions, corporate governance, and general corporate and securities matters. Since joining Skadden, Mr. Breheny has advised numerous clients on a full range of SEC compliance and corporate governance matters, including advising clients on compliance with the provisions of the Dodd-Frank Act, the SEC’s tender offer rules and regulations and the federal proxy rules.

Prior to joining Skadden in 2010, Mr. Breheny held a number of leadership positions in the Division of Corporation Finance at the U.S. Securities and Exchange Commission. He began as chief of the SEC’s Office of Mergers and Acquisitions in July 2003, and in November 2007 he became deputy director, legal and regulatory policy.

In his position as chief of the Office of Mergers and Acquisitions, Mr. Breheny oversaw the legal and technical aspects of the administration of the Securities Act of 1933 as it related to tender offers and mergers; the proxy, beneficial ownership reporting, tender offer and going-private provisions of the Securities Exchange Act of 1934; and the rules, regulations, forms and procedures promulgated to implement these statutory provisions. As deputy director, he was a member of the senior staff of the commission with responsibility for the division’s legal and regulatory policy support offices (chief counsel, chief accountant, mergers and acquisitions, international corporate finance, rulemaking, small business policy and enforcement liaison).

During his tenure at the SEC, Mr. Breheny assisted the commission with its consideration of significant rule amendments in a number of areas including shareholder director nominations, tender offers, beneficial ownership reporting, electronic delivery of proxy materials, electronic shareholder forums, short sale disclosure, and proxy voting and shareholder communications.

Before joining the SEC, Mr. Breheny worked at another international law firm in its New York and London offices. During his previous seven years in private practice, he advised clients engaged in a broad range of merger and acquisition transactions, securities issuances, private equity investments, banking and public financings, fund formations and corporate reorganizations. Mr. Breheny began his career as a certified public accountant with KPMG LLP.

Mr. Breheny was recognized by the National Association of Corporate Directors as part of its Directorship 100, an annual list that identifies the most influential people in the boardroom community. He also was selected for inclusion in Chambers USA: America’s Leading Lawyers for Business 2013 and The International Who’s Who of Corporate Governance Lawyers 2013.