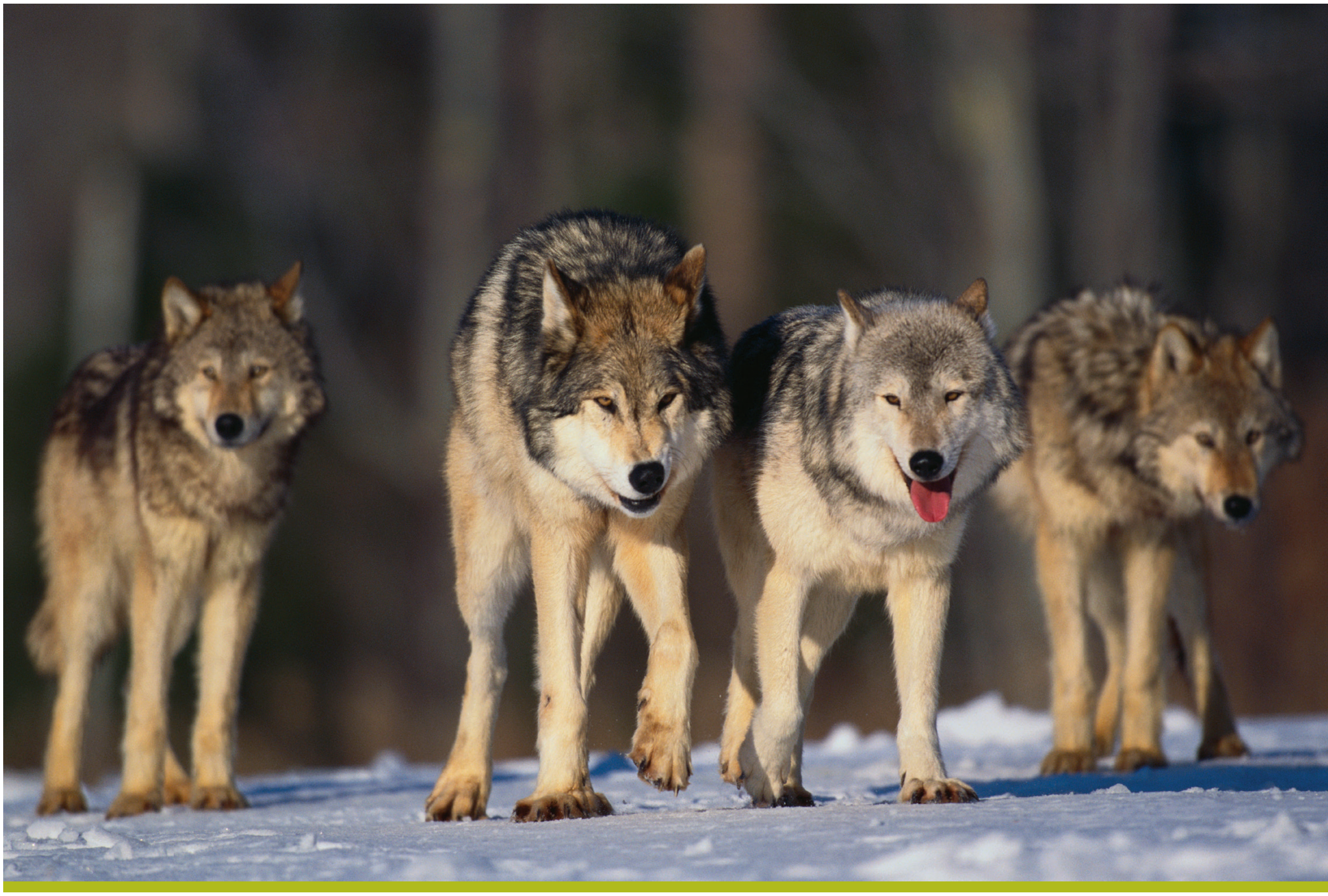
Facts Favor the Bold in a Proxy Fight



CORPORATE RAIDERS ARE OUT. CORPORATE ACTIVISTS ARE IN.

Hedge funds flush with cash are pressing companies for significant changes. Even executives seem more willing to pursue acquisitions they have long coveted. In this climate, companies need to be on alert for when — not if — they receive that phone call or email saying, “Game on!”

What has become clear in recent years is that the winners of proxy battles or hostile, unsolicited bids are those who can gather the most accurate information and use it effectively to make their case.

Just ask Yahoo. In 2012, activist investor Daniel Loeb sent a letter to Yahoo’s board of directors alleging that its new CEO Scott Thompson had inaccurately added a computer science degree to his resume. Less than two weeks later Yahoo confirmed the misstatement. This powerful use of information immediately undermined Thompson’s credibility, resulting not only in Thompson’s resignation but also in board seats for Loeb and his Third Point Investments.

Some of the most iconic raiders of the 1980s and 1990s, such as Carl Icahn and Nelson Peltz, have transformed themselves into activists, claiming that through their efforts to take control of a board or to effect changes at a company they improve shareholder value. Unlike in previous eras, they are garnering the support of regulators. In December 2013, SEC Chairman Mary Jo White publicly legitimized corporate activism stating, “It was not long ago that the ‘activist’ moniker had a distinctly negative connotation… But that view of shareholder activists, which has its roots in the raiders of the 1980s takeover battles, is not necessarily the current view and it is certainly not the only view.”

Regardless of whether one is the challenger or defender, accurate, objective information plays a critical role in the outcome of proxy battles. Facts are regularly and strategically used to:

- Arm board committees, legal counsel, management, and other advisors or the dissidents themselves
- Debunk claims made by the other side or to further one’s own argument
- Inform the legal and public relations strategy in these battles

Is Change Better?

At the heart of many battles is the veracity or viability of claims. How did activism affect shareholders in prior situations where the activist challenged management?

- Did the stock price rise or fall?
- Did the business performance improve?
- How did a company fare when it was acquired?
- Was management retained?
- Did performance decline?

Getting the answers to these and similar questions in a timely fashion allows management to decide whether to engage the challenger or fight. Similarly, understanding how a company has reacted if it were targeted in the past or analyzing the competency of its current board will provide direction to activists on how best to pursue their strategy with that company.

If an activist company has a history of poor outcomes for shareholders, this information can be used to make direct arguments to other large shareholders considering their options, as well as to fuel “fight letters.” For example, an analysis of earnings, share price, and other performance metrics during the time of the activist’s board tenure on another publicly traded company may demonstrate that the activist’s involvement in the past did not increase the shareholder value of that company. In this case, the targeted company may decide to aggressively rebuff the dissident slate.

It is crucial to not accept statements made by either side at face value. When one company was pressured by a dissident shareholder to sell a significant division, the company hired a team of investigators to assess the rationale for the sale. The investigators not only established that the group hired by the shareholder to value the division lacked the training and expertise to make such a valuation, but also found the valuation was not independent, as represented in SEC filings. In fact, the group had profited by processing trades for the dissident's hedge fund.

What's Included [or Not] in a Disclosure?

Whether beginning a proxy battle or a hostile takeover, advisors pore over the disclosures made by the other side to identify misleading or inaccurate statements, a process The Wall Street Journal recently called "bed bugging." The Securities and Exchange Commission has issued strict rules about what must be disclosed in solicitation material. Even with these requirements, omissions or misstatements are not uncommon and also raise the question of what inconvenient fact is left out, and why.

For example, in a recent proxy fight, investigators identified a Delaware Chancery Court opinion that determined that a dissident had failed to adequately disclose his principal occupation for the prior five years. The court found that the nominee misstated the nature of his involvement with a previous employer, inaccurately disclosed the length of his tenure with another, and failed to disclose an unpaid internship with his current partner in the fight, stating "a shareholder or director … would certainly want to know and would have a right to know." Once these inconvenient facts came to light, the dissident group withdrew the nominee's name from consideration.

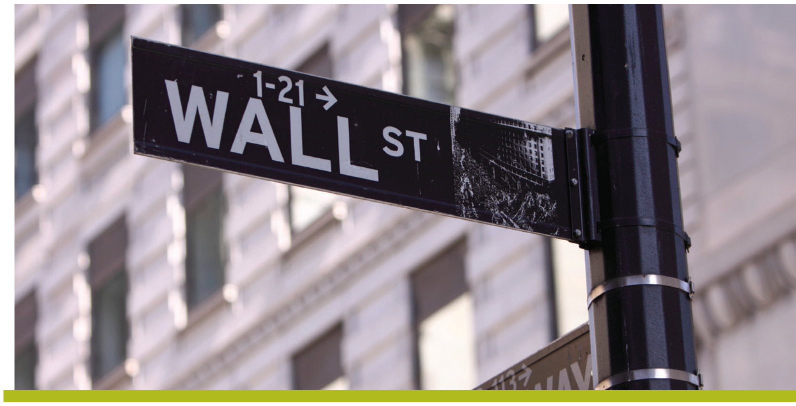
Inadequate disclosures are not limited to nominees. In another recent fight, an investigation revealed a sitting director failed to disclose that he had previously served as the chairman of an audit committee of a publicly traded company that had restated its financials and filed for bankruptcy. Although the director was not technically required to disclose this experience, the dissident group made a successful argument that this information was material to his experience to serve as a director of the current company.

While a thorough review of public filings, litigation and media reports can aid in identifying discrepancies and embellishments in resumes, biographies and proxy filings, uncovering pivotal facts such as undisclosed relationships and conflicts of interest often involves discreet interviews with key sources.

Friends … or Not?

In today's world, activists are finding support in new places. "Wolf packs" — like-minded investors following each other in informal groups — are making a comeback. This can make activism hard to combat because these investors do not have a formal agreement to act in concert, which would require written notification.

With the increase in wolf packs, corporations must look more broadly at their shareholders in order to assess who is likely to be part of these groups. Analyzing the



historical holdings of hedge funds can help predict who is following whom into a stock, even though they are not acting in concert. Knowing which investors typically follow the lead of activists can help a company gauge more accurately which shareholders are likely to vote with the activists in a battle. This in turn helps the company target its message to these shareholders. Case in point: investigators recently helped a company analyze its major shareholders in order to develop a strategy for dealing with individual members of a suspected wolf pack. By looking at these holders past activities, the investigators were able to identify which of the non-activist shareholders were likely to be influenced by or vote for the dissident group.

In what seems to be a new twist on old "stalking horse" tactics, corporations are teaming up with activist hedge funds directly. In a direct alliance in early 2014, Valeant Pharmaceuticals teamed up with hedge fund manager William Ackman and his Pershing Square Capital to launch a hostile bid for Botox maker Allergan, possibly ushering in a new era of activist investing. Although the bid ultimately failed, Ackman, who had invested heavily in Allergan, will make a sizeable return on his investment as Allergan has agreed to be acquired by Actavis, another large drug maker. Valeant, on the other hand, has been left rethinking its strategy. Its failed bid could easily be used as fodder in its next fight.

In this landscape, it is essential that both challengers and defenders choose their friends wisely by fully understanding who has what at stake and the potential rewards and fallout. Looking at the successes, failures and alliances of entities such as these will help to inform corporate strategy.

Who's Talking? Who's Listening?

Today, both sides of the battle are playing out on the public stage through real-time use of social media, blogs, and websites devoted solely to furthering an argument. Gone are the secretive battles waged in the boardroom or through proxy or other materials sent directly to shareholders. Instead a broad group — including shareholders, hedge funds, regulators, banker attorneys, and members of the media — begin to form their strategy around statements or misstatements that are made by the other side.

For example, in a recent analysis of an activist group's past actions, investigators found the group had successfully launched a proxy fight for another company. After taking control of the board, the fund orchestrated the sale of most of the company's assets, laid off the majority of the workforce, and then used the company to launch additional proxy fights. This information was used successfully in both legal and public relations strategies to combat the activists.

What Next?

So, what became of Third Point and Yahoo? A year after joining the Yahoo board and pushing it to hire Marissa Mayer as CEO, Third Point's dissident nominees resigned their directorships. Third Point reduced its stake to 2 percent, selling the majority of its stake back to the company at $28 per share and netting about $1 billion on the shares it had purchased at $15 per share. Today Yahoo's stock price is hovering around $50. Despite these successes, another activist is knocking at Yahoo's door. In September 2014, Jeffrey Smith's Starboard Value sent a letter to Yahoo's board urging it to "unlock the value of Yahoo's non-core minority equity stakes" and to merge with rival AOL.

Yahoo's case makes it clear that even with success, a company is never safe from the next activist. As corporate activism is projected to continue increasing, both sides in battles for corporate control will likely get more creative in their strategies and tactics. Accurate, timely, comprehensive and objective information will play a crucial role as investors, boards, dissidents, and companies themselves make claims about what is the best outcome for the company.

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