

Activist Investing Strategies

Dan Kusnetz, David Rosewater, Marc Weingarten

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Private
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Funds
Seminar

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About the Speakers





Dan Kusnetz

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Dan Kusnetz is a partner in the Tax Group at Schulte Roth & Zabel LLP. His practice concentrates in tax planning for complex transactions, including mergers & acquisitions, private equity, structured finance, real estate and bankruptcy.

Dan received his LL.M. in taxation from New York University School of Law; his J.D., *magna cum laude*, from Tulane University Law School, where he was managing editor of the *Tulane Law Review* and Order of the Coif; and his B.A., *cum laude*, from Tulane University. He is a member of numerous tax bar organizations and is a frequent speaker on tax topics at conferences.

Significant recent engagements and transactions include:

- Representation of Cerberus Capital Management LP in the acquisition of a controlling interest in Chrysler LLC.
- Representation of an institutional real estate investor in a \$3 billion leveraged recapitalization of a real estate joint venture.
- Representation of a major investment bank in connection with the formation of Argentine and Brazilian real estate private equity funds.
- Tax counsel to a major European bank in the acquisitions of controlling interests in fund-of-funds (hedge and private equity) managers with over \$4 billion of assets under management.
- Advisor to France's largest publisher in the acquisition of a leading U.S.-based publishing company.
- Tax counsel to a public company in connection with \$3.65 billion worth of acquisitions, and related financing, of directory-publishing businesses.
- Tax advisor to private investment funds on activist investing strategies and execution.
- Formation of numerous hedge funds and private investment funds.
- Representation of private equity investment funds in connection with private equity acquisitions, dispositions, the formation of investment vehicles, subsequent-round investment financings and general tax planning.



David Rosewater

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David Rosewater is a partner in the Business Transactions Group at Schulte Roth & Zabel LLP. His practice focuses on private equity, mergers & acquisitions, leveraged buyouts and activist investing.

David received his J.D., *cum laude*, from New York University School of Law, and his B.A., *with distinction*, from the University of Michigan.

Some of David's merger & acquisition representations include:

- Cerberus Capital Management LP, in connection with the acquisition of 51% of GMAC LLC from General Motors Corp.;
- Cerberus Capital Management LP, in connection with the acquisition of the Austrian bank Bawag P.S.K. from ÖGB (the Austrian Trade Union Association);
- Cerberus Capital Management LP, in connection with the acquisition of the Mervyn's department store chain;
- Cerberus Capital Management LP, in connection with the acquisition of Newell Rubbermaid Inc.'s cookware, glassware and picture-frame businesses;
- Leucadia National Corp., in connection with the acquisition of a controlling interest in WilTel Communications Group Inc.;
- The CIT Group/Commercial Services Inc., in connection with the acquisition of the factoring businesses of GE Capital Corp. and HSBC Business Credit (USA) Inc.;
- Cerberus Capital Management LP, in connection with its acquisition of a majority interest in EXCO Resources Inc. pursuant to a management buyout;
- Representation of SSA Global Technologies Inc., in connection with its acquisitions of Infinium Software Inc. and EXE Technologies Inc.; and
- Cerberus Capital Management LP, in its acquisition of Cingular Interactive LP.

David also regularly represents activist investment clients, including The Children's Investment Fund, Clinton Group, Sandell Asset Management Corp. and OSS Capital Management.



Marc Weingarten

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Marc Weingarten is a partner in the Business Transactions and Investment Management Groups at Schulte Roth & Zabel LLP. His practice focuses on mergers & acquisitions, leveraged buyouts, securities law and investment partnerships. Marc's transactional prowess has earned him numerous awards and recognitions, including listings in *The Best Lawyers in America 2008* and the *Lawdragon 500 Leading Dealmakers in America*. In 2007, he was named a "Dealmaker of the Year" by *The American Lawyer*.

Marc is one of the leading lawyers representing activist investors, and has advised on many of the most significant activist campaigns in recent years. His representations include:

- JANA Partners and SAC Capital in the campaign involving Time Warner Inc.
- Trian Group in its successful proxy contest with H.J. Heinz Co.
- JANA Partners in its campaign involving Kerr-McGee
- The Children's Investment Fund Management in its pending campaign involving CSX Corp.
- Pershing Square in its investments in McDonald's and Target Corp.

On the transactional side, recent representations include:

- Cerberus Capital Management in the acquisition of an 80% interest in Chrysler from DaimlerChrysler
- Castle Harlan in the organization of LBO funds and the negotiation of buyouts of restaurant chains, a media company, an insurance company, publishing ventures and other transactions
- Cerberus Capital Management in the acquisition of control of GMAC from General Motors
- Cerberus Capital Management in the acquisition by tender offer of a controlling interest in Aozora Bank in Japan
- Morton's Restaurant Group in IPO and secondary offerings, proxy contests, acquisitions and dispositions, and high-yield refinancing

Marc received his J.D. from Georgetown University Law Center, where he was an editor of the *Georgetown Law Journal*, and his B.A. from the University of Pennsylvania's Wharton School. He is a member of the American Bar Association, the New York State Bar Association and the New York City Bar Association, where he formerly served on the Committee on Corporation Law and currently serves on the Committee on Mergers, Acquisitions and Corporate Control Contests.

Outlines



FIRPTA FAQ Frequently Asked FIRPTA Questions For the Activist Investor

Dan Kusnetz

Tuesday, January 15, 2008

1) What is FIRPTA?

FIRPTA is the acronym for the Foreign Investment in Real Property Tax Act of 1980. This statute was passed in 1980 out of concern that foreign investors in U.S. real estate were able to outbid U.S. investors because foreigners are generally not taxable in the U.S. on their capital gains from portfolio investments.

2) What did FIRPTA change?

Foreign portfolio investors are generally not taxable in the U.S. on their capital gains. This does not include capital gains that are “effectively connected with the conduct of a U.S. trade or business.” FIRPTA decreed that capital gains realized by foreign persons on U.S. real estate investments would be treated *as though* such gains were effectively connected with a U.S. trade or business. In this way, such gains would be subject to tax in the same manner as if they were in the hands of a U.S. person.

3) Is this fair?

Who ever said that U.S. tax laws were fair?

4) Do activist investment funds care?

Yes, if they have foreign investors. Because most activist funds are set up to provide “pass-through” tax treatment, any capital gains realized by funds should be tax free to foreign investors in the fund, unless FIRPTA applies. If FIRPTA applies, those capital gains will be fully subject to U.S. taxation.

5) So what? Isn't my carried interest calculated on a pre-tax basis?

That may be true, but it is a very shortsighted view. Investors will not be pleased to learn that an investment which they thought would be free from U.S. tax will be subject to tax. There is always the next fund you want to raise to keep in mind.

6) But is there any impact on my fund, or on the manager?

Yes. FIRPTA is enforced through a tax-withholding mechanism. If the fund (through its manager) fails to make the proper withholding of tax, then the fund (and the manager) may become personally liable for the tax to the extent that the foreign investor fails to pay the tax, and may become liable for penalties even if the foreign investor does pay the tax. This is the case even if the decision to not withhold was based on a good-faith, but ultimately erroneous, belief that FIRPTA did not apply.

7) But activist funds do not invest in real estate, so why should we be affected?

You may not *think* you are investing in real estate but FIRPTA defines “real estate” very broadly.

8) All we invest in is corporate stock, and swaps and other derivatives tied to stock. And our target companies are not REITs. How could that be considered real estate?

Good question. But stock can quite easily be real estate for FIRPTA purposes. In order to capture real estate investments held through corporations, the statute treats the stock of domestic U.S. corporations as U.S. real estate if more than half of the fair market value of the corporation's trade or business assets constitute U.S. real estate interests. By the way, just to show you how little sense some of the FIRPTA rules make, interests in domestically controlled REITs are never subject to FIRPTA (although distributions from those REITs may be subject to FIRPTA).

9) But if all stock could be a FIRPTA asset, wouldn't that grind the public markets to a halt?

The statute provides that, as a general matter, publicly traded classes of stock will not be subject to FIRPTA. The exception does not apply, however, for persons who, during the five-year period preceding the sale in question, owned more than 5% of the class of stock sold (the "5% Problem").

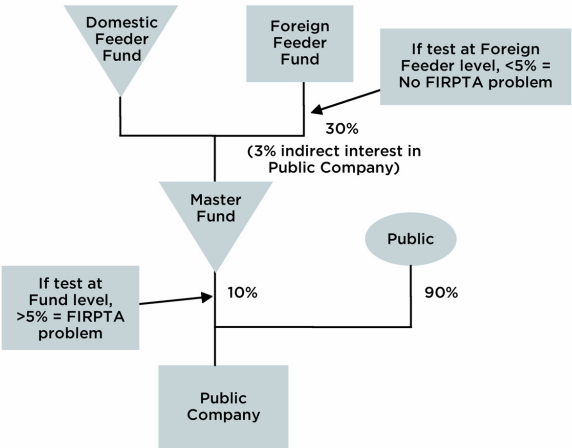
10) So as long as I don't hold more than 5% of the stock I am not subject to FIRPTA?

In theory yes, but the devil is in the details. There are very comprehensive constructive-ownership rules that apply to cause related parties to be deemed to own stock owned by each other. For example, stock owned by a partnership is deemed owned proportionately by each partner. Similar rules apply to trusts. The rule for corporations is even more restrictive than the normal attribution rules. If 5% or more of the stock (by value) of a corporation is owned by a person, that person is deemed to own the stock owned by the corporation. Similarly, corporations are deemed to own all of the stock that is owned by each of its 5% shareholders.

11) How does that rule work in a family of commonly managed funds?

The rules under FIRPTA were not written in contemplation of investments through funds; the rules are from the '80s and are quite outdated. Most of the rules were written assuming that a single investor or a small partnership would be the foreign investor. Accordingly, the rules are ambiguous and unclear when applied in modern contexts. The attribution rules work on related ownership, not related management. So, in side-by-side investment funds, provided that a partner in one fund is not also invested in the other fund, there should generally not be attribution of ownership. In a master-feeder structure, the issue becomes more difficult. If the testing for 5% ownership is done at the master-fund level, the 5% Problem becomes more acute. If, however, the 5% ownership testing is done at a feeder fund above the master fund, the likelihood of having foreign ownership above 5% becomes more remote.

Because the rules are unclear, there are technical arguments that the testing should be made at the master-fund level. This seems like the wrong result and we generally are of the view that testing should not be done at pass-through entity levels where those pass-through entities have both foreign and domestic owners. At a minimum, the test should only be done at the level of a true foreign investor, or at least where a foreign individual or corporation is involved. The regulations on a similar issue in the portfolio interest exemption from withholding are instructive on this point and provide a reasonable result.



12) But if my fund goes over 5%, what's the big deal? Can't I just sell down below 5%, pay a little tax, and then close out the rest of the position tax-free?

No. You didn't really think it would be that easy, did you? The rules are very sticky. Once a relevant holder goes over the 5% threshold, the 5% Problem remains until he has been below 5% for five years. Assume that a foreign investor amassed a 6% position in public stock of a U.S. company with significant real estate holdings. In year two, that entire position is disposed of and the foreign investor pays U.S. tax on its capital gains. In such a case, if the foreign investor reinvests in the same class of stock four years later, but only buys a 3% position, that investor's holding is still tainted and will still be subject to FIRPTA even though a second 5% position is never amassed.

13) How do you determine whether a company is subject to FIRPTA?

The determination of a company's status as a U.S. Real Property Holding Corporation ("USRPHC") is one of the more problematic areas in applying FIRPTA. The regulations put the duty of determination in the hands of the foreign investor, but give the investor limited tools with which to make that determination. The regulations provide that the foreign investor may establish the USRPHC status of a corporation in one of two ways: obtain a statement of that status from the corporation itself, or obtain a determination from the IRS. If the foreign investor does not do either of these, the stock of the corporation is presumed to be subject to FIRPTA.

14) But that's not fair!

See answer to question (3) above.

15) Doesn't that give the target company too much leverage in the determination?

Yes. In the activist context, very often the last thing you want to do is to tip off the target that you are considering amassing a 13D reportable position. Accordingly, until after you go over the 5% reporting threshold, you often do not want the target to know of your interest in the company. This means that you will not be able to confirm the presence or absence of a FIRPTA problem without either first tipping your hand or waiting until it is too late and you already have a 5% Problem. Because a target might want to find ways to make its stock a less attractive investment for activist funds, the target might choose to make the judgment calls inherent in making a USRPHC determination in such a way to find that FIRPTA does apply to large foreign owners of its stock. It may become a sort of "poor man's poison pill."

16) How is the USRPHC determination made?

The test is whether the fair market value of the U.S. real property interests held by the corporation (generally within the past five years) equals or exceeds 50% of the sum of the fair market values of the corporation's total real property interests (both U.S. and foreign) and the value of the corporation's other assets used or held for use in the corporation's trade or business.

17) What assets are counted?

Clearly, all real estate interests are to be valued. The value of all U.S. real property goes into the numerator and the value of all real property goes into the denominator. As for the other assets that go into the denominator, only assets "used or held for use in a trade or business" get included. Clearly inventory and most depreciable property will qualify. Cash and other financial assets (stock, securities, receivables, commodities contracts, etc.) are included only to the extent that they are held for use in the trade or business. Investment assets are excluded. The biggest category, however, is that goodwill, going-concern value and other intangible assets (including IP rights) are included too, as long as they are used in the corporation's trade or business.

18) How is fair market value determined?

The value of an asset for this purpose is the gross value of the asset. Gross value does not permit netting of most related indebtedness and is determined to be the price at which the asset would change hands between a willing buyer and seller with reasonable knowledge of the applicable facts and under no compulsion to buy or sell. Debt secured by the asset may reduce the value of the asset if it was purchase-money debt or was incurred “in direct connection with the property” (such as tax liens and construction loans). The regulations specify that as a general rule assets should be valued at their going-concern value.

19) Are there special valuation concerns for goodwill?

Yes. Intangible assets (including goodwill) that were purchased from unrelated parties are valued at cost less GAAP amortization. Otherwise, the presumption is that book value of intangibles is to be used. If a taxpayer wants to use some other form of valuation to prove the price at which the intangible would be sold by a willing seller to a willing buyer, that may be done; however, special notifications to the IRS must be made concerning the alternate valuation methods used.

20) How is the fair market value of leases determined?

This is usually a very critical aspect to the valuation exercise given that many corporations hold much of their real property in leasehold form. The rules require that the value is the “price at which the lease could be assigned or the property sublet.” The rules go on to indicate that the present value of the difference between market rent and the rent under the lease is the correct value. Where a lease is nonassignable, and where sublets are prohibited, the value of the lease is zero. However, this is the case only where the lease precludes—as opposed to conditions—assignments and subleases. Accordingly, landlord-consent rights are not treated as precluding assignments or subleases, although the practical effect of such consent rights will have to be considered in determining the value of the leasehold.

21) What are the obvious hot-button issues?

Often the biggest issue is the separation in value between goodwill/going-concern value and the value of a lease. For example, in the case of a fast food-restaurant chain, is the value of each location increased by virtue of the identity of the fast food-chain’s brand name? Or is the value inherent in the property itself? Even if the target company passes the FIRPTA test at the time of investment, consideration should be given as to how the company will fare under the test over time. Spinoffs or other dispositions of unwanted or non-core assets could cause a company to become a USRPHC in the future, thereby creating taxability to foreign investors just at the time when the activist business plan is beginning to bear fruit.

22) Can you provide some common examples of cases where USRPHC status might arise?

- Investment in a distressed restaurant chain. Due to the distressed nature of the business, goodwill may be nonexistent or at a historically low value and the portfolio of owned and leased locations may be at least half of the company’s asset value.
- Investment in an auto parts manufacturer. In the current environment for auto-related manufacturing, another distressed-company play, because the test focuses on the fair market value of the assets rather than their book or tax-basis values, the fair market value of factories, warehouses, and other facilities may exceed the value of the other assets of the company.
- Investment in a hotel, retail, prison or similar facility operator. Despite the fact that these are operating businesses and that investor valuations may be determined on a multiple of earnings or cash flow, when the FIRPTA test is applied it may be that the fair market value of the real estate emerges as a significant component of value. In addition, personal property associated with operations can be treated for FIRPTA purposes as real property in certain

cases (e.g., in the case of a hotel, beds, furniture, televisions, telephone systems, laundry equipment and lobby furnishings can all be treated as real estate assets for purposes of applying the test).

- Investment in an owner/operator of cell towers: In general, these companies merely lease space and own transmission and related equipment. Nonetheless, the FIRPTA regulations require that the value of personal property associated with the use of real estate must be included in the determination of real estate values. This rule may mean that cell tower operating companies will have almost all of their asset value as real estate for FIRPTA-testing purposes.

23) As an activist investor I will not have detailed access to the assets of the target and will not be able to appraise them. How can I determine the USRPHC status of the target company?

There is an alternate test that may be used. The fair market value of a corporation's U.S. real property interests may be presumed to be less than 50% of the aggregate value of the corporation's trade or business assets if the total book value of the U.S. real property interests is 25% or less than the value of the aggregate of the company's trade or business assets. Book value can be determined from the company's publicly reported financial statements.

24) That seems like a much better approach than tracking down every asset and getting appraisals. Why wouldn't I use this method every time?

It is true that the book-value test is far easier to apply and is often used in order to confirm that a company is not even close to being a USRPHC. However, there are many problems with relying on the book-value approach. First, it is only a presumption. If it turns out that despite the fact that U.S. real property interests are less than 25% of the value of the total trade or business assets, they are highly appreciated and exceed 50% by fair market value, the presumption is lost and the stock in the corporation becomes taxable. Second, it is unclear whether the presumption applies if the book value test is made by a stockholder instead of being made by the target corporation. Finally, without the cooperation of the target company, it will generally be difficult to obtain schedules to the publicly available financial statements that break out and identify the assets in sufficient detail. Is PP&E located in the U.S. or abroad? Which assets are held for use in the trade or business and which are not? What about the book value of assets held at subsidiaries where the financial statements of the subsidiaries are not available?

25) OK, then, bottom line, what should an activist investor do?

When evaluating a company that may become a target of an activist campaign, FIRPTA should be on the list of items to consider and investigate at the outset. While there may be no way to determine with certainty whether the company is a USRPHC that would create a 5% Problem for the funds, the FIRPTA issue should not come as a surprise after the 5% ownership threshold has been achieved. And, of course, call a tax lawyer at Schulte Roth & Zabel LLP to assist you in making the determination.

Short Slates, Majority Slates and Full Slates: Strategic and Voting Considerations

Marc Weingarten

Tuesday, January 15, 2008

The ultimate threat available to an activist that seeks to cause a company to take actions it advocates for maximizing shareholder value is obtaining representation on the board from which the activist can advocate, or effectuate, change from within. The prospect of one or more shareholder designees entering the boardroom is sufficiently unappetizing to most boards that its likelihood, especially in combination with the express will of the shareholders in supporting the activist's position, is often enough to spur the incumbent board to take at least some of the desired actions.

Where a target company's board is staggered, the activist typically is limited to seeking to replace those minority directors whose staggered terms expire at the next annual meeting. Unless it is possible to remove directors without cause, or to expand the size of the board, and, in either case, to elect replacement directors, the activist typically would not have the ability to run a control (majority) slate of directors or to replace the entire board. However, at companies whose boards are not staggered (i.e., the entire board is up for election at each annual meeting, or through expansion/removal at a special meeting or by consent), the activist has the option of running a short (minority) slate, a control (majority) slate or a full slate.

Strategic Considerations

As the activist's goal is to cause the recalcitrant company to take the actions it advocates, the ideal situation would be for the activist to run either a control or full slate, if it had the legal right to do so; if successful, its designees would then comprise a majority of the board and could cause the company to take the desired actions. By contrast, a successful short-slate campaign would yield only minority board representation that would be unable to cause the desired action without "winning over" some of the incumbent directors.

In determining which slate to run, when the choice is available, the principal consideration is typically the likelihood of success in the election. Replacing a majority of the board effects a change of control of the company, and the likelihood of winning a change-of-control fight is considerably less than for a short slate. One common objection waging a change-of-control fight is that shareholders expect to be paid a change-of-control premium by the control acquirer, whereas the activist who acquires control through a proxy contest does so "for free." This objection may be mitigated where the campaign platform is to sell the company, in which case the shareholders would receive the change-of-control premium if the activist wins (and was right about the prospects for sale). This would also be the case, albeit to a lesser extent, where the actions advocated by the activist (sale or spin-off of parts, buybacks, recap, etc.) would result in an immediate increase in shareholder value, which "premium" the shareholders can realize by selling their stock. The premium becomes more tenuous, or at least discounted for delay and execution risk, where the activist advocates an operational turnaround which would take much longer to achieve and would be subject to additional risk of success.

But in any of the above scenarios, shareholders would have a concern not only about the lack of control premium upon the change of control, but also about the risk that the activist's strategy will fail to produce the desired results after the reins of control have been passed over and that the activist (whose ideas have failed) is not the optimal control person for the long term. This is the very concern that underlies the support for staggered boards—that there is a real benefit to preserving continuity for a majority of board members in view of their institutional knowledge and understanding of the company and its operations, personnel, plans and problems, and that an abrupt change would be too destabilizing. While these concerns could be outweighed by a company's poor performance, the burden of persuasion on the activist is high.

No doubt as a result of these very concerns, the hurdle to obtaining support from Institutional Shareholder Services ("ISS") and the other proxy advisory firms is considerably higher for a control slate than it is for a short slate. Many institutional shareholders follow, or are at least heavily influenced by, such recommendations, so their support can be critical in a proxy contest. ISS has fairly routinely supported short slates where the company is a poor performer and the dissident nominees are qualified, presumably because it views the addition of minority directors selected by a large and active shareholder to be a positive catalyst for improvement without the disruption and risk of a change of control. To obtain support for a majority slate, the dissident must present ISS with a detailed plan for the poorly performing company and convince the voting advisory service as to the likelihood of execution. Absent that, the chances of obtaining support are considerably lower.

A variety of other strategic considerations will also inform the activist's decision whether to run a short or control slate. First, there may be incumbent board members who the activist is happy to leave on the board—such as those that may be viewed as sympathetic to the activist's agenda, senior management who may be highly regarded and whose input at the board level may be invaluable, board representatives of other important constituencies (suppliers, customers, labor, government, community), and highly qualified independents. Second, election of a control slate may well result in the triggering of change-of-control provisions in company debt agreements, employment agreements, severance agreements and other material contracts, resulting in considerable expense and disruption. The mere possibility of a change in control can result in disruption of a variety of critical company relationships, with customers and potential customers, suppliers, laborers and others. Third, the change of control shifts the burden of overseeing operations squarely to the activist, with a significant commitment of time and responsibility.

Voting Issues

Rule 14a-4(d)(1), promulgated under Section 14 of the Securities Exchange Act of 1934, provides that no proxy shall confer authority upon the solicitor to vote for any person who is not a bona fide nominee. (The text of Rule 14a-4(d) is set forth in Annex A). This is the so-called "bona fide nominee rule." Under Rule 14a-4(d)(4), a bona fide nominee is one who consents to being named in the proxy statement and agrees to serve if elected. As incumbent directors rarely, if ever, consent to being named as nominees in the dissident's proxy statement, this meant that the dissident running a short slate could not offer shareholders the opportunity to vote for a combination of dissident nominees and incumbent directors (denying the shareholder the ability to vote for a full slate of directors, as many may have wished), and led to shareholders "splitting tickets" by seeking to vote for both dissident and incumbent directors, often with unintended results. To address this situation, the SEC modified the bona fide nominee rule so that it now allows a dissident who nominates a short slate which, if elected, would constitute a minority of the board, to simultaneously seek authority to vote for nominees named in management's proxy statement (the "short slate rule"). Under the modified rule, the solicited shareholder is able to support the dissident's

minority short slate while preserving the ability to vote towards the board's majority or full composition.

However, Rule 14a-4(d) only allows the incorporation of management's nominees into the dissident proxy ballot if four conditions are met: 1) the dissident must seek authority to vote in the aggregate for all of the board seats then up for election, 2) the dissident must disclose its intention to vote for all of management's nominees except for those specified, 3) the solicited shareholder must have an opportunity to withhold authority with respect to any other management nominee by writing the name of such nominee on the proxy form and 4) both the proxy form and the proxy statement must disclose that there is no assurance that management's nominees, if elected, will serve with any of the dissident's nominees.

The short slate rule does not, however, permit a shareholder filling out a dissident proxy card to (1) vote for less than all of the dissident nominees and still vote a full slate by adding votes for additional incumbents who the dissident was not supporting or (2) vote for the dissident slate but also vote for a different mix of incumbents than the dissident supports. A similar limitation applies to the company's proxy: A shareholder cannot cast its votes on the company's card and split its votes for incumbents and dissidents.

This can be solved, at least as to Internet and phone voting, if both parties agree to let the service provider give shareholders the ability to vote for any mix of nominees it chooses. However, such agreements are hard to come by as one side or the other will believe it has an advantage sticking to the letter of the short slate rule. This compromise will also require the agreement of, or at least a lack of opposition from, the SEC, which we understand may be obtainable.

The only other avenue for a shareholder to mix and match nominees is to obtain a "legal proxy" from its broker (for shares held in street name), attend the meeting in person and vote on the manual ballots distributed—a cumbersome and expensive process that only the most dedicated, and likely largest, shareholders will even consider pursuing.

Where an activist nominates a control slate, the short slate rule is not available, and so a shareholder wishing to support the activist and voting on its proxy card can vote for all the dissident nominees but will be unable to vote for a full slate of directors. This can raise significant problems for shareholders who wish to exercise their full shareholder franchise and show support for at least some of the incumbents, and may even present a legal concern for shareholders, such as pension plans, that sometimes argue that their fiduciary duties require them to vote for full slates.

In conclusion, keep in mind that voting complications vary with the size of the slate, and that potentially unintended results can flow from the short slate rule and split-ticket voting, requiring careful planning with a proxy solicitor both before and during a campaign.

Annex A

The text of Rule 14a-4(d):

(d) No proxy shall confer authority:

(1) To vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement,

(2) To vote at any annual meeting other than the next annual meeting (or any adjournment thereof) to be held after the date on which the proxy statement and form of proxy are first sent or given to security holders,

(3) To vote with respect to more than one meeting (and any adjournment thereof) or more than one consent solicitation or

(4) To consent to or authorize any action other than the action proposed to be taken in the proxy statement, or matters referred to in paragraph (c) of this rule. A person shall not be deemed to be a bona fide nominee and he shall not be named as such unless he has consented to being named in the proxy statement and to serve if elected. Provided, however, that nothing in this section 240.14a-4 shall prevent any person soliciting in support of nominees who, if elected, would constitute a minority of the board of directors, from seeking authority to vote for nominees named in the registrant's proxy statement, so long as the soliciting party:

(i) Seeks authority to vote in the aggregate for the number of director positions then subject to election;

(ii) Represents that it will vote for all the registrant nominees, other than those registrant nominees specified by the soliciting party;

(iii) Provides the security holder an opportunity to withhold authority with respect to any other registrant nominee by writing the name of that nominee on the form of proxy; and

(iv) States on the form of proxy and in the proxy statement that there is no assurance that the registrant's nominees will serve if elected with any of the soliciting party's nominees.

Presentation



SchulteRoth&Zabel

17th Annual
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Activist Investing Strategies

Dan Kusnetz, David Rosewater, Marc Weingarten

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Swaps and 13D

David Rosewater

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Equity Swaps in **Activist Situations**

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Overview of **Rules**

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Perceived **Abuses**

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Unwind of **Swaps**

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Swap Disclosure

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13D Amendments

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FIRPTA: A Problem for Activist Investment Funds

Dan Kusnetz

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"Let me put this in terms you'll understand. First,
you'll have to tell me what language you're speaking."

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- **Foreign Investment in Real Property Tax Act**

- Enacted in 1980
- An exception to general rule that foreign investors are exempt from U.S. tax on capital gains
- FIRPTA gain is U.S. trade or business gain
 - Fund documents may limit or prohibit such investments

Stock Can Be Real Property for FIRPTA Purposes

- **Stock in U.S. corporations can be treated like U.S. real property if 50% or more of corporation's fair market value is attributable to U.S. real property interests**
- **Publicly traded stock is usually OK up to 5%**

Publicly Traded Exception

- **5% Rule for Publicly Traded Stock**
 - Stock must be regularly traded on an established securities market
 - Accumulation of >5% position can cause nontaxable capital gain to become fully taxable in hands of foreign investors
 - Five-Year Taint—Very sticky rule

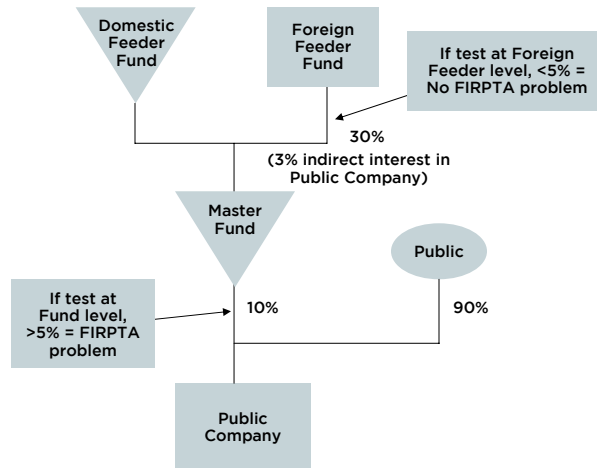
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Stickiness

- **Once 5% threshold is met, the stock remains subject to FIRPTA for five years**
- **Reducing position to less than 5% does not cure the problem**
- **Attribution of ownership rules apply**
 - Related parties are deemed to own each other's assets

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How to Count to Five



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Valuation Testing

- **U.S. Real Property Holding Corporation**
 - Applies if $\geq 50\%$ of fair market value of assets are U.S. real property interests
 - Status lasts for 5 years
 - Determination to be made by target corporation or IRS—otherwise company is presumed a USRPHC
 - Alternate test based on 25% of book value has flaws but may be helpful

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Slates: Control or Not

Marc Weingarten

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Slates: Board Seats

Why seek them?

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Slates

- **Staggered board**
- **Non-staggered board**
 - Short slate—fewer nominees than seats to be elected, and less than a majority
 - Majority, or Control, slate
 - Full slate

Majority Slates: Hard to Win

- **Lack of control premium**
- **Risk: Plans fail**
- **Higher hurdle at ISS**

Control Slates: Additional Negatives

- **Collateral consequences—change of control triggers**
- **Loss of beneficial incumbents**
- **Disruption**

Short Slates: Voting Considerations

- **Bona fide nominee rule**
- **Short-slate rule**
 - Permits full-slate voting, including incumbents supported by activist
 - Only available if running **minority** slate
 - Shareholder still can't "mix and match"

Voting Considerations

- **Split tickets**
- **Majority slate voting issue: disenfranchisement**

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