

activist investing developments

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

By Marc Weingarten

The ultimate threat available to an activist who seeks to cause a company to take actions it advocates for maximizing shareholder value is obtaining representation on the board through 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 from other shareholders where an activist is 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." A common response by the activist is that it is not acquiring control, particularly where its slate is dominated by independent director nominees—the shareholders are simply voting on a newly-composed board. In addition, 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, but also

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.

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 Risk Metrics/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 operating plan for the company and convince the voting advisory service as to the likelihood of successful 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 the box [see left]). 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 telephone voting, if both parties agree to let the service provider give a shareholder 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 believe to 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. ■

Coming Events

April 16 | Hilton New York, New York
SRZ Investment Management Hot Topics: Investment Opportunities in Distressed Credit Markets

Philippe Benedict, Stephanie Breslow, Stuart Freedman, Adam Harris, John Pollack and Craig Stein

April 13-16 | The Ritz-Carlton, Grand Cayman
GAIM Cayman 2008

Harry Davis

May 7 | University of Chicago - Gleacher Center, Chicago
PLI Hedge Funds 2008

David Nissenbaum

May 8 | Hilton New York, New York
SRZ Investment Management Hot Topics: Navigating the World of FCPA, OFAC and AML

Martin Perschetz, Betty Santangelo and Gary Stein

May 21 | Harvard Club, New York
The Private Equity Financial Management Summit

Phyllis Schwartz

June 1-4 | The Fairmont Southampton, Bermuda
IBA 19th Annual Conference on the Globalization of Investment Funds

Stephanie Breslow

For more information, contact Wesley Gross at 212.610.7285 or wesley.gross@srz.com

Proxy Campaign Websites and the Compliance Questions They Raise

By David E. Rosewater and Avital Gopas



More and more activist shareholders are utilizing proxy campaign websites as a means of disseminating information to other shareholders when contemplating or actively pursuing a proxy contest. Such websites have proved a relatively low cost and highly efficient method of disseminating both the initial information regarding proposed changes activist investors seek to effectuate and the form of proxy later on.

As investor creativity increases the ways in which activists reach out to other shareholders, questions about compliance with the SEC rules arise. Many investors wish to include press releases, live streaming of analyst reports and hyperlinks to other sources discussing the state of the company or management's performance. Such features raise legal concerns regarding liability for both the content of the communications and their form.

General Compliance Considerations

In terms of content, a website must, even in the early stages of a proxy contest, comply with Rule 14a-9 regarding the accuracy of the information it contains. The website must not contain any statements that, in light of the circumstances and time at which they were made, are false or misleading with respect to a material fact. Materiality depends on whether the information in question would have influenced a reasonable shareholder's vote on the matter in question.¹ The website must also not contain a statement which omits a material fact necessary to render that statement not misleading or false. Some areas of potentially misleading information are:

- Predictions as to specific future market values;
- Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation;
- Failure to so identify a proxy statement, form of proxy or other soliciting material of any other person or persons soliciting for the same meeting or subject matter; and
- Claims made prior to a meeting regarding the results of a solicitation.²

It is advisable to periodically review and update the website to avoid inadvertently violating these rules through obsolete

postings. Although the SEC has not directly imposed a duty to update in this context, it has expressed that "electronically delivered documents must be prepared, updated, and delivered consistent with the provisions of the federal securities laws in the same manner as paper documents."³ Because a website can be viewed as continuously "republishing" the information it contains, its information should be accurate and not misleading at all times so long as the site is open. Nonetheless, as a precautionary measure, it is advisable to include a legend disclaiming the responsibility to update.

There are also several restrictions on the format of the website with which to comply. The user should, upon entering the website, be prompted to accept or reject a disclaimer regarding the purpose and intended use of the website, and there should be a legend on the site advising security holders to read the proxy statement when it becomes available.⁴ It is advisable that the website be accessible only to users who accept the disclaimer.

The SEC does not require pre-clearance of materials to be posted to the website. However, all soliciting material that is placed on the website or made accessible by hyperlink must be filed with the SEC (as well as any exchange on which the company's shares are listed) not later than the date on which the material is first made available to shareholders on the website.⁵

In addition, security measures to protect the website from being accessed and changed without the activist investor's consent should be instituted. The security systems should be reviewed and updated regularly and the website should be monitored to ensure that it remains accessible and has not been altered.⁶

Liability Regarding Third-Party Information and Hyperlinks

The SEC considers all materials posted to the website the responsibility of the activist investor posting them.⁷ This includes information produced by third parties (such as analyst reports and news reports) and external information accessed via hyperlinks.

The SEC has stated that inclusion of a hyperlink within a document required to be filed or delivered under the federal securities laws renders the posting party responsible for the hyperlinked information as if it were part of the document. The reasoning behind this requirement is that inclusion of the hyperlink demonstrates "the hyperlinking party's intent to make the information part of its communication with investors, security holders and the markets."⁸ Although this statement was issued in the context of Section 10 prospectus concerns, the SEC noted in the same release that:

"some securities lawyers have raised similar issues concerning the use of a web site in connection with proxy solicitations, tender offers and other transactions that require documents to be filed or delivered under the federal securities laws. Although the guidance in this section focuses on issues relating to the registration process, it applies by analogy to all documents required to be filed or delivered under the federal securities laws."⁹

In addition, the use of reprints or reproductions, in whole or in part, of previously published material must (1) state the name of the author and publication, the date of prior publication, and identify any person who is quoted without being named in the previously published material; (2) state whether or not the consent of the author and publication has been obtained for the use of the previously published material as proxy so-

liciting material, except where the quoted material is a public or official document;¹⁰ and (3) if any participant paid for the preparation or prior publication of the previously published material, state the circumstances of the arrangement.¹¹

Further, the activist investor also should be aware that posting third-party content and including hypertext links to third-party (target) websites at which third-party content can be accessed raises issues under relevant copyright and unfair competition laws. For example, copyright law gives the owner of a copyrighted work the exclusive right to reproduce, distribute and publicly display the work. To legally post a copyrighted work to a proxy campaign website, therefore, the activist investor would either have to obtain the copyright owner's express or implied consent or the use of the copyrighted work would have to constitute "fair use" under copyright law.

Allowing visitors to navigate to a third-party website or to an article contained on the inner page of a third-party website ("deep linking") by clicking on a hypertext link also raises legal issues. Generally, it is presumed that there is an implied right to use a URL or a domain name link to a third party's web page. However, use of a third party's logo as a hyperlink would probably require consent, and deep linking may, in some circumstances, constitute unfair competition.¹² Further, where a third-party website has a posted notice prohibiting deep linking or allowing it only under certain circumstances, failure to obey the posted policies or requirements can defeat a claim of implied license to deep link.

Accordingly, prior to posting any third-party content (e.g., newspaper articles or commentary) or providing hypertext links to websites containing such content, the activist investor should check to make sure that its use of such content or hypertext links is permitted and complies with any restrictions or requirements imposed by the copyright owner or target website operator.

Other features, such as applications encouraging viewers to leave their email addresses in order to receive news updates and other information, are common and normally acceptable.¹³ The SEC does not require the filing of copies of emails sent in response to inquiries from shareholders requesting further information. However, other unsolicited email messages that do more than request the return of previously solicited proxy forms must be filed.¹⁴

The insertion of a blog on a proxy campaign website presents special problems under the proxy rules. A blog is intended to be a forum for expression of opinions and concerns. As such, its inclusion is likely to attract statements from shareholders that would be in violation of the proxy rules or other laws.

The Communications Decency Act of 1996 protects any "provider or user of an interactive computer service" from being "treated as the publisher or speaker of any information provided by another information content provider." Thus, Internet service providers are somewhat shielded from liability for postings on online bulleting boards. Such protection, however, focuses mainly on potential defamation and copyright liability and not on the violation of securities laws. Furthermore, the act has not been expanded beyond Internet service providers to protect companies operating bulletin boards on their websites. Even if the act were extended to such cases, it is unlikely that its protection would cover non-issuer proxy campaign websites, or aiding-and-abetting liability.¹⁵

Thus, to avoid liability, a blog needs to be reviewed regularly and edited significantly. The constant monitoring and editing of the blog may prove too burdensome to justify its presence on the website. It is also unclear whether every blog entry would have to be filed with the SEC. If true, such a require-

ment might also render the blog too burdensome for inclusion on the website. Some commentators also have questioned whether communication between investors over the Internet may turn such investors into a "group" under Section 13(d).¹⁶

Internet Publication of Proxy Materials Requirements

Rule 14a-16 was recently amended to require that, as of Jan. 1, 2008, issuers and other soliciting persons posting their proxy materials to a website provide notice to shareholders of the availability of these materials on the Internet.¹⁷ Should the activist investor decide to include such proxy materials on its website, there are additional features that must be implemented to avoid violation of this rule. For example, the website must not infringe on the anonymity of its viewers. Thus, the activist investor must refrain from installing cookies and other tracking features on the pages where the proxy materials are posted. While the rule does not require turning off the connection log, which automatically tracks numerical IP addresses that connect to that website, in most cases these IP addresses do not provide sufficient information to identify the accessing shareholders, and such data may not be used in an attempt to find out more information about persons accessing the website.¹⁸ In addition, proxy materials should be available in both a searchable HTML version and a version convenient for reading and viewing graphics, such as PDF.¹⁹

¹ Harold S. Bloomenthal, *Securities and Federal Corporate Law*, 2nd Ed. (2007) Thomson West.

² Exchange Act Rule 14a-9.

³ SEC-REL, FSLR 3200 [Use of Electronic Media for Delivery Purposes] Release No. 33-723, 10/05/1995.

⁴ Exchange Act Rule 14a-12(a)(ii).

⁵ Exchange Act Rule 14a-6(b).

⁶ Some exchanges have suggested these security measures for Investor Relation websites. See, e.g., Toronto Exchange Electronic Communications Disclosure Guidelines, Part III, Pg. 4; available at <http://www.tsx.com/en/pdf/ElectronicCommunications.pdf>.

⁷ See SEC Staff Comments to Time Warner Inc., 02/03/2006, comment 6. (Advising about the dissident campaign website: "Please note that we would consider all soliciting materials found on this website to be the responsibility of the participants irrespective of whether or not the participants actually produced the content found in the posting.")

⁸ SEC-REL, SEC-DOCKET 72 SEC-DOCKET 753-1, 04/28/2000 n.41.

⁹ *Id.* at n. 38.

¹⁰ It is advisable to include such statements in the disclaimers section of the website.

¹¹ Exchange Act Rule 14a-12.

¹² See *TicketMaster v. Tickets.com*, 54 U.S.P.Q.2d 1344 (C.D. Cal. 2000) (court recognized that deep linking combined with other activity could result in unfair competition, for example, where users are not aware that they were being taken to another company's website via the hyperlink). Companies have also been successful in relying on theories of trespass to stop unauthorized use of a target website, at least where the volume of traffic to the target website is substantial. See e.g., *eBay, Inc. v. Bidder's Edge, Inc.*, 100 F. Supp. 2d 1058 (N.D. Cal. 2000).

¹³ Eugene F. Cowell, "Internet Technology Permits New Proxy Contest Techniques," *INSIGHTS*, Oct. 2001, Pg. 17.

¹⁴ Exchange Act Rule 14a-6(f).

¹⁵ See 47 U.S.C. § 230(c); see also Howard M. Friedman, *Securities Regulation in Cyberspace*, 3rd Edition (1997 & supplemented 11/06), Chapter 13.04.

¹⁶ Exchange Act Rule 13d-5(b): "When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership . . . as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons." See Friedman at 12.02.; See also Karen Donovan, "The Web-A Valid Proxy for Proxy-Fight Notices?," *National Law Journal*, Volume 18, Number 22 ("discussion among investors over the Internet could also create potential violations of SEC Rule 13D . . . The SEC could misconstrue mere discussion as a united effort.")

¹⁷ See David E. Rosewater, Young J. Woo, "Internet Publication of Proxy Materials Can Cut Costs in Proxy Contests," *Activist Investing Developments*, Summer 2007, Schulte Roth & Zabel LLP; See also SEC-REL, FSLR 487,933, Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 56135. Investment Company Act Release No. 27911, 07/26/2007 n. 11. ("Proxy materials" include proxy statements on Schedule 14A, proxy cards, information statements on Schedule 14C, annual reports to security holders required by Rules 14a-3 and 14c-3 of the Exchange Act and notices of shareholder meetings.)

¹⁸ *Id.* at A(1)(f).

¹⁹ Exchange Act Rule 14a-16(c). ■

authors



Marc Weingarten is a partner in the business transactions and investment management groups at Schulte Roth & Zabel LLP. His practice focuses on mergers and acquisitions, leveraged buyouts, activist investing and investment partnerships.

212.756.2280 | marc.weingarten@srz.com



David E. Rosewater is a partner in the business transactions group at Schulte Roth & Zabel LLP. His areas of concentration are mergers and acquisitions, leveraged buyouts and all aspects of activist investing.

212.756.2208 | david.rosewater@srz.com

Avital Gopas is an attorney in the business transactions group.

Business Transactions Partners

Stuart D. Freedman
Robert Goldstein
Peter J. Halasz
Eleazer Klein
Michael R. Littenberg
Robert B. Loper
Benjamin M. Polk
John M. Pollack
Richard A. Presutti
David E. Rosewater
Paul N. Roth
Marc Weingarten
André Weiss

Investment Management Partners

Stephanie R. Breslow
David Efron
Marc E. Elovitz
Steven J. Fredman
Kenneth S. Gerstein
Udi Grofman
Peter J. Halasz
Christopher Hilditch
Kelli L. Moll
David Nissenbaum
Omoz Osayimwese
Paul N. Roth
Phyllis A. Schwartz
George M. Silfen
Marc Weingarten

Schulte Roth & Zabel LLP

919 Third Avenue, New York, NY 10022

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