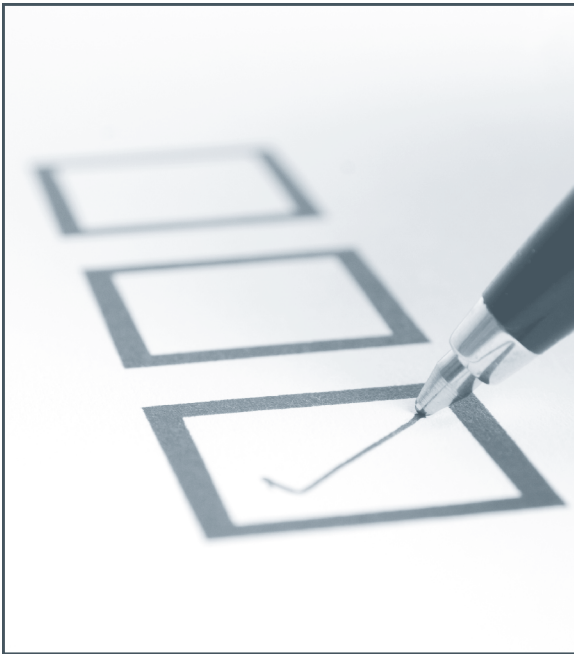


activist investing developments

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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 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

continued on page 2

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

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.

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

continued on page 3

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. ■

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