THE ACTIVIST REPORT

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10 Questions with Marc Weingarten

Marc Weingarten is chair of the Business Transactions Group at Schulte Roth & Zabel LLP where his practice focuses on mergers & acquisitions, leveraged buyouts, corporate governance, securities law and investment partnerships. One of the leading lawyers representing activist investors, he has advised on many of the most significant activist campaigns in recent years. Marc was able to make time to sit down with us for this month's edition of 10 Questions.

13DM: You represent a great many activists, and have been involved in some of the most significant contests over the years. How did you get involved in the business?

MW: It really started in the eighties, representing Asher Edelman in all of his hostile fights. Many involved proxy contests, and that's where I really learned the trade. Many of today's activists were in the mix back then, as were many of today's proxy solicitors and public relations firms. So I've known all the players for a long time. And my firm has a premier practice in advising hedge funds, so they've naturally turned to us for advice on activism.

13DM: What advice do you give your activist clients about approaching management? When should they first approach them and what should the tone of that conversation be?

MW: I generally recommend that they approach management in a constructive way prior to going public with their activism. That way management can give them a hearing without getting defensive in response to a public attack, and the activist may get some valuable insight into the situation at the company which they couldn't know as an outsider. That may enable them to reshape or sharpen their platform, or at least anticipate the company's response. And it increases the likelihood that the company will adopt the activist's proposal, or settle, without looking publicly like they've been pushed to do so. Having private discussions first also gives you more credibility later with institutional shareholders, rather than coming at the company out of the blue with all guns blazing.

13DM: You have represented activists in hundreds of campaigns. What is the main factor that distinguishes a winning campaign from a losing campaign?

MW: Picking the right target is the most critical factor. If the company is a demonstrably poor performer over a significant term, compared to peers and a relevant index, with a very unhappy shareholder base, you've got a situation primed for success. Where it hasn't done that badly, but the activist just thinks it could do better, you've got an uphill battle. If you've picked the right target, then it's all about execution-winning the hearts and minds of the other shareholders with a clear, consistent, well-articulated message.

13DM: Are there any new trends in shareholder activism you've seen in this most recent season?

MW: One trend clearly is activists going after larger-cap targets. There's no mystery as to why-they're doing it because they can. The sector has seen enormous capital inflows in recent years, reflecting the excellent returns. A number of new activist funds have started up, spun out of places like Icahn and Pershing Square, and launched with over a billion in capital. And if you can get institutional investors to support you, you can win even if you only own a percent or two of the outstanding. No company is immune.

Another trend this year was for more majority board fights than ever before, with greater success than in the past. They're much harder fights to win than where you're just looking for minority board representation-ISS requires that you prove you have a superior business plan, and the companies scare the other shareholders with fears about "disruption" and harp on the failure of the activist to pay a premium for its supposed acquisition of control. But particularly where the activist is seeking management change, often the only practical way to achieve it is with majority board change. There have been several majority board contests this year, which may also be partly attributable to the decline in staggered boards. And many more have been successful than historically.

13DM: Activism is certainly evolving and becoming a widely accepted strategy. Even Marty Lipton recently called it an "asset class." Do you see more hedge funds adopting an activist strategy? It seems like many hedge funds who

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historically never filed 13Ds are starting to be 13D filers and alleging that they will utilize activism as a strategy from time to time.

MW: Yes, we're seeing many more hedge funds which would never call themselves activists trying out the strategy now when they're stuck in a position where they think they can unlock value. We call them "occasional activists". Earlier this year we represented TPG-Axon in its campaign for Sandridge Energy. They're not an activist fund, but they'd been invested in Sandridge for a long time and were incredibly frustrated by what they saw as mismanagement by an imperial CEO who stood in the way of value realization on some really terrific assets. And right now we're in the middle of the fight for control at Vivus. We're advising First Manhattan, which again is not an activist fund, and has been invested in Vivus since 2008. Vivus has an FDA-approved anti-obesity drug called Qsymia, the most effective drug in the sector and which should be a blockbuster billion-dollar plus seller, but First Manhattan thinks they've badly fumbled the launch of the drug and is looking to replace the entire board with candidates with much more drug commercialization experience. I think these "occasional activists" in some ways have more credibility with other investor/shareholders than activist only funds-they're long-term investors who have suffered alongside their fellow shareholders and are putting their money where their mouths are to try to improve things for everyone. They really can't be accused of short-termism, and they go active not because "it's what they do" but, to the contrary, it's not what they do but they're incensed at corporate mismanagement that has destroyed value.

13DM: There have been a recent spate of activist situations where large shareholders ignored, at least in part, ISS's recommendation for the incumbent Board (i.e., Tessera, DSP Group, Morgans Hotel). This is not the first time that shareholders have gone against ISS, but it is the first time that I can remember where they have gone against the recommendation for management – and three times in a couple of weeks. Are shareholders becoming more independent in their voting decisions?

MW: Many of the largest institutional investors are becoming more independent. Several of them-BlackRock, Vanguard, State Street and Fidelity, for example-have developed highly sophisticated in-house capabilities to make proxy voting decisions, with their own detailed policies and guidelines. They still use ISS, but mainly for informational purposes. These investors are now another stop on the campaign trail-they'll listen to both the activist and management, and then make their own voting decision. They don't automatically follow ISS recommendations-they have their own agendas.

13DM: There has been much discussion about changing the 13D rules as allowed by the Dodd-Frank Act, particularly in shortening the 10 day filing period. What are your thoughts on this?

MW: The Wachtell proposal to shorten the 10-day window has nothing to do getting earlier notice to issuers and the market-the Hart Scott rules, advance notification bylaws and poison pills already do a perfectly fine job at that. It's simply an attempt to further tilt the playing field in favor of corporates by reducing the potential profit of an activist and so disincentivizing them from undertaking a campaign at their own expense and risk for the benefit of all investors. The Williams Act 13D rules were intended to provide early disclosure of potential hostile acquisitions of control, not appeals to shareholders to exercise their voting franchise to maximize value, and ought not to be tightened to deter activism. But I think the pressure from corporates to shorten the 10-day window, particularly by comparison to the shorter windows in other countries, will be overwhelming. If that happens, it should really be coupled with an increase in the threshold for reporting-to at least 10%-as the ownership of just 5% of a company's stock is really not a threat to control, let alone a level at which an activist should be stopped out.

13DM: If you could add or change one corporate governance rule, what would it be?

MW: The one change which I believe would be most meaningful would be to permit shareholders to amend the corporate charter without the necessity of the board having to first be in favor of doing so. The charter is the fundamental corporate document which governs shareholder rights, and I don't believe that the private owners of a company should be able to impose their will, and their entrenching rules, on the public owners in perpetuity. It should be a cost of going public that the charter can be changed by the public shareholders. If the private owners want to insure their continuing control, they should keep the company private.

13DM: Are there any proxy rule changes on your wish list?

MW: I believe the proxy rules should be changed to permit the use of universal proxies. When a shareholder attends the meeting in person, they can vote on a ballot which lists all of the director candidates from both sides, and can pick and choose whatever combination of candidates they prefer. But if they vote by proxy, they can only vote on the card supplied by either the activist or the company, and can't freely split their votes for the particular nominees

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they prefer. That's a serious limitation on the shareholder franchise, and really should be remedied. ISS and Glass Lewis frequently recommend split voting, but there's no way to really split your votes when voting by proxy. A simple modification to the bona fide nominee proxy rule would fix this problem and facilitate universal proxies.

13DM: There have been recent high profile proxy fights where the activist agreed to personally compensate its nominees if they were elected to the Board. These arrangements have been criticized by some. Do you see more of this in the future and how do you structure these arrangements to placate some of the more outspoken critics?

MW: I do think we'll see additional attempts at this in the future, coupled with educational campaigns to explain to shareholders why these arrangements are justified and beneficial. Activists are not on equal footing with corporates to attract board nominees-they're asking distinguished corporate executives to get involved in fight for board seats, risk the mud-slinging that can happen in a campaign that can damage their reputation, and all without any assurance of success. And the activists are trying to recruit the absolute best board candidates available-industry "rock-stars". It's natural and appropriate that they need to pay these candidates more than the company would. The argument that this would result in different classes of directors with different economic incentives is silly. We have that now, where different directors have very different levels of options with differing expiration dates, or differing levels of stock ownership, and some directors who represent majority or private equity owners and whose compensation in their day jobs will vary based on company performance. But the special incentives to the activist nominees will need to be tied to value creation over a longer term, like three years, rather than when the activist decides to exit. I've got to believe that pay for performance in the board room can be made to work.

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