

Fall 2020

Schulte Roth & Zabel Shareholder Activism Insight

A Schulte Roth & Zabel report in association with Activist Insight and Okapi Partners

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CONTACTS

**Marc Weingarten**

Partner and Co-Chair
Shareholder Activism Group
+1 212.756.2280
marc.weingarten@srz.com

**Eleazer Klein**

Partner and Co-Chair
Shareholder Activism Group
+1 212.756.2376
eleazer.klein@srz.com

**Aneliya Crawford**

Partner
+1 212.756.2372
aneliya.crawford@srz.com

**Jim McNally**

Partner
+44 (0) 20 7081 8006
jim.mcnally@srz.com

**Michael Swartz**

Partner
+1 212.756.2471
michael.swartz@srz.com

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In September 2020, Schulte Roth & Zabel commissioned Activist Insight to interview 45 respondents from different activist firms. The survey sample consisted of economic activist funds that have engaged over 400 companies since 2013, including some of the largest and most high-profile situations, and manage a combined total of at least \$347 billion.

Respondents were asked about their experience with shareholder activism in their respective regions and their expectations for activity in the next 12 months. All respondents are anonymous and results are presented in the aggregate. Percentages are rounded to the nearest whole, which may cause rounding errors.

SCHULTE ROTH & ZABEL FOREWORD

Marc Weingarten, Ele Klein, Aneliya Crawford, and Brandon Gold

When we published our foreword in the February 2020 Shareholder Activism Insight report, we couldn't have predicted the far-reaching impact of the COVID-19 pandemic on American and international markets, including on shareholder activism. Now that we've settled into a "new normal," nine months into the pandemic, a shift in tone from public companies has emerged, which, in many cases, showcases a defensive and preemptive approach, especially toward corporate governance.

The poison pill in play

Most notably, during the first three quarters of 2020, 55 Russell 3000 companies have implemented a poison pill, marking a 324% increase over the previous record holder year for poison pills (17 pills in 2017). The forbearance of Institutional Shareholder Services (ISS) and Glass Lewis for limited duration "COVID pills," which the proxy advisers vowed to review on a case-by-case basis, may have contributed to this outcome. Nevertheless, these defensive steps may be unnecessary in light of numerous reports that the number of companies publicly subjected to activist demands in the United States has declined 11% in the first three quarters of 2020, compared with the same period in 2019.

Handshake settlements

Though handshakes have been replaced with Zoom waves in the boardroom, they may be getting a bigger shake in the world of activist settlements. As we prefaced in our February 2020 foreword, late 2019 and 2020 have brought about a number of settlement pacts without formal, written settlement agreements and associated activist standstill restrictions. These so-called "handshake settlements" have played out between some of the industry's biggest headliners, including many we have worked on with our clients. Examples include KKR at Dave & Buster's Entertainment, D. E. Shaw at Emerson Electric, and Elliott Management at AT&T.

While it's doubtful that formal settlements will go the way of office-based happy hours, informal settlements appear to

be a positive development for activists who want to eschew standstill restrictions while still effectuating change – and for issuers that prefer to avoid formal attachments.

Companies going virtual and social

As a result of health concerns, travel restrictions, and social distancing norms, many public companies have elected to hold their meetings virtually instead of in-person. Delaware, for example, has long permitted virtual shareholder meetings, while other states such as New York have passed legislation temporarily allowing a virtual format. Though this trend alleviates pressures on activists to attend in-person shareholder meetings to present proposals, it also gives companies greater control over meeting procedure and shareholders less presence before other shareholders.

As COVID-19 has accelerated the digitization of corporate procedures, it has also likely amplified social pressures that have greatly impacted corporate policy. We believe 2020 has been a banner year for companies to place a greater focus on the needs of stakeholders rather than simply shareholders. Executive pay has come yet again into the limelight, as shareholders are beginning to indicate that they will not support lavish executive compensation for those companies facing capital crunches. Moreover, certain reports indicate that shareholders are beginning to sound louder and louder calls for executive pay to be more closely tied to ESG targets. Time will tell whether this shift in focus is merely a response to the times, or the beginning of something more permanent.

Conclusion

As the pandemic persists, we expect the activist landscape to continue to evolve through the fourth quarter of 2020 and into 2021, as those companies whose poor performance was masked by robust or even overbought market conditions will need to face the pressure of shareholders who demand value and swift and meaningful action by corporate boards and managers in the face of a rapidly changing world. ■

ACTIVIST INSIGHT FOREWORD

Josh Black

Few years can be said to have made a greater impression on the world than 2020, and yet so much of the long-term impact is uncertain.

The coronavirus pandemic led to vast changes in working patterns, employment, and economic demand, while forcing listed companies to embrace virtual meetings and other electronic means of communicating with their shareholders. It is unclear whether these changes will reverse themselves in the absence of COVID-19, or how long it will take to control the spread of the virus or vaccinate large chunks of the population. Having been down by more than 30% at its lowest, the S&P 500 Index was up for the year-to-date following the election.

In a U.S. presidential election year, politics has also left its imprint. The Securities and Exchange Commission's Republican majority succeeded in passing new regulations on proxy voting advisers and shareholder proposal thresholds that will take effect in 2022 and moved universal ballots to its short-term agenda. The Department of Labor proposed new rules on environmental, social, and governance (ESG) investing by pension funds. The advent of a Democratic presidential administration brings new policy priorities – many of them vague at present – but with a weak legislative power base.

All of this makes it a perfect time to survey activist investors for their opinions on what the future holds for their business. The results are fascinating and sometimes contradictory.

On the one hand, 47% of respondents thought the pandemic was significantly or somewhat favorable to activism, while over 20% thought it made no difference. And yet, 36% thought the U.S. market was overcrowded and that it was hard to find good targets there (more than the 27% that disagreed). In 2018, when we last conducted this survey for Schulte Roth & Zabel, 33% thought the U.S. was overcrowded and 39% disagreed, so the slight decline in the quantity of activism we saw in the first three quarters of 2020 may continue.

Perhaps understandably, given how large it has loomed in the global activist investing landscape for so long, no other regions get close to the opportunities presented by the U.S. (see page 14). But there is enthusiasm for some markets, particularly the U.K. even as it negotiates a new relationship with the European Union to replace its membership in the bloc. Surprisingly, fewer respondents expected to make new investments in Japan than did so in France and Germany. Whether that suggests that Japan will see a decline in activism or just less interest from generalist or globally minded funds remains to be seen.

Those readers that are familiar with our two previous surveys will note the return of familiar topics, such as settlements, due diligence, and fundraising. We have added some new categories among a select group of questions that we hope will reflect some of the changes in topics of conversation in recent years. These show that environmental and social vulnerabilities may be the most significant category for companies according to our respondents (from third place in 2018), although employee welfare ranks pretty far down the list of screening tools and therefore may not be a common area of criticism in 2021.

This year has also been a significant one for Activist Insight and I wanted to take a brief moment to highlight our merger with Proxy Insight for readers that may have missed this. The combination, resulting in a new company called Insightia, allows us to combine our global focus on tracking activist investors, corporate governance, and vulnerability to activism, with new data sources on investor voting and ESG shareholder proposals.

Finally, I want to thank Schulte Roth & Zabel for again commissioning Activist Insight to carry out this report and for Okapi Partners for supporting its publication. We hope you find its conclusions enlightening in an otherwise disorienting year! ■

Josh Black, Editor-in-Chief, Insightia
jblack@activistinsight.com

A TRANSFORMATIONAL YEAR

Bruce Goldfarb, CEO of Okapi Partners

What corporate actions do you expect institutional investors and proxy advisory firms will focus on from issuers' responses to COVID-19?

It's been clear from our conversations with investors that executive pay practices during COVID-19 will be important. Investors want to know that management shares in the experience of the pandemic along with employees and shareholders.

But more importantly, investors will scrutinize how management and the board responded to the crisis. A significant part of that scrutiny involves the transparency that companies provide investors into how management planned to sustain the business through the crisis and protect stakeholders. Investors and proxy advisory firms will take a close look at how companies dealt with their annual meetings, dividends and buybacks, and stock option grants during the second quarter when the pandemic was at its height.

The decisions made by companies themselves won't necessarily be the focus on their own, but the disclosures and communications around those decisions will be closely examined. As I wrote earlier this year, many companies will need to do a better job engaging retail shareholders as that base of investors has surged during the pandemic. That means clearly communicating to them what the company has done to mitigate the effects of COVID-19.

What are activists doing now that is new and innovative?

Activists of all sizes are doing a more thorough analysis of the shareholder base of a potential target – really digging into the makeup of the investors prior to launching any campaign. This quest for information is one reason why investors vehemently opposed the Securities and Exchange Commission's proposed changes to 13F disclosure. Identifying shareholders can be more of an art than a science, especially if the top holders are constantly changing.

When activists are sizing up a campaign, they often reach out to us to understand who the other shareholders are and what issues concern them. If there's little chance of support from the

rest of the shareholder base, it's unlikely a sophisticated activist will move forward with a campaign. This evaluation is especially important now that retail investors have had such a big impact on the investment landscape.

What weaknesses will activists be looking to exploit?

As activists raise capital in longer-term vehicles with different lock-up provisions, we expect intense focus on operational activism. Activists that come to the table with a solid strategic and operational plan (sometimes with a management team capable of executing that plan) are going to become more commonplace. We also think these campaigns will ultimately be the most successful. COVID-19 made these operational changes more difficult as many companies have already begun transformations. But as investors start thinking more about coming out on the other side of COVID, they will be looking for companies that have underperformed during the crisis and failed to take the appropriate operational steps to remain competitive.

How do you anticipate that environmental, social, and governance (ESG) issues will be affected by this year?

Firstly, ESG issues will become operating issues for some companies.

In terms of the shareholder franchise, ESG issues played a very prominent role in this year's proxy season, but next year will be even more important. Earlier this year, BlackRock publicly identified 244 companies that haven't addressed climate change adequately enough, either through their practices or disclosures to shareholders. The firm voted against directors at 53 of those companies and said it will vote against directors at the other 191 next year if they fail to make "significant progress" over the coming 12 months. That's an important warning that should draw the attention of all company boards and activists.

Given the activity this year, companies are certain to face even more proposals on diversity and inclusion, racial justice, socioeconomic inequality, health and safety, climate change, and other ESG-related factors in the 2021 proxy season. You can bet activists will also make some of these proposals part of their demands. ■

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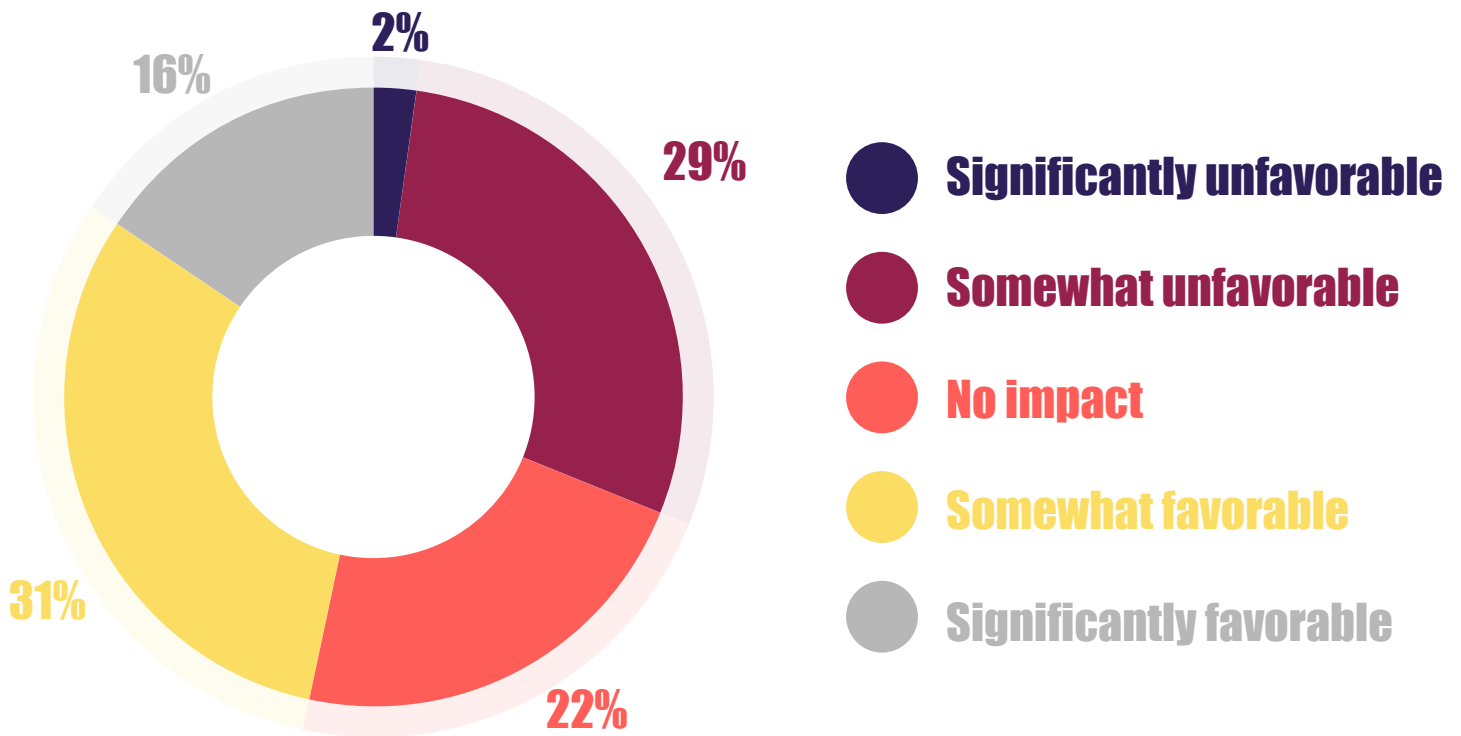


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1212 Avenue of the Americas, 24th Floor
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+1.212.297.0720

AN INFLECTION POINT

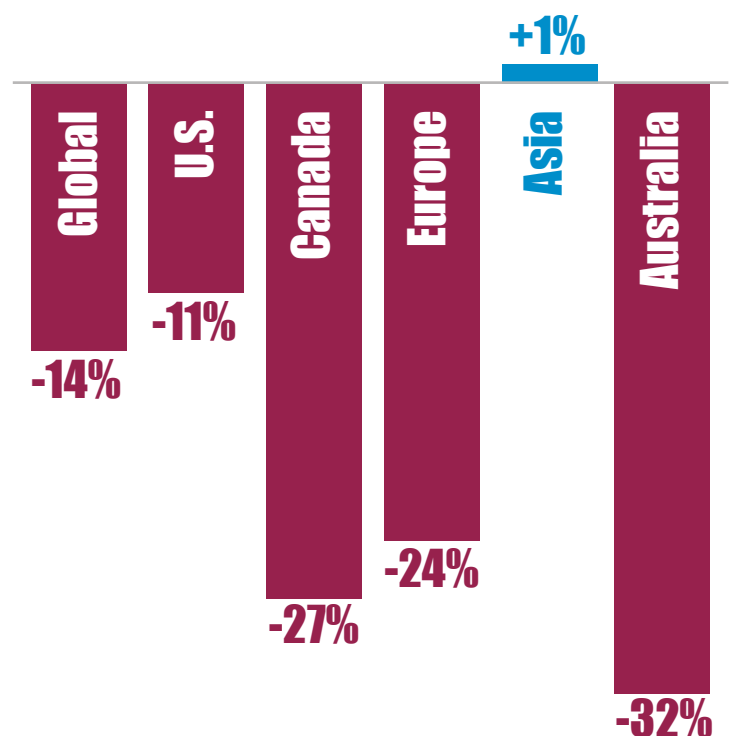
How will COVID-19 impact shareholder activism over the next 12 months?



“COVID-19 has impacted activism in many ways, including the annual meeting. Virtual shareholder meetings became the norm this past year. Time will tell whether this gives companies an edge through more control or whether easier attendance and fair treatment allow shareholders more of a presence.”

Ele Klein, Schulte Roth & Zabel

Companies targeted worldwide



Companies publicly subjected to activist demands in Q1-Q3 2020 versus Q1-Q3 2019 by company HQ. Source: Activist Insight Online.

Please elaborate on the impact of COVID-19 on activism.

“I still think activists will be hesitant to take on companies while the virus is still raging in the U.S. Plus, it is harder to have conviction in an idea because the lasting impact of COVID has yet to be determined.”

“When equities are driven by virus duration / vaccination, activism has a more muted impact on stock prices. However, offsetting this is increased volatility which is favorable for accumulating new positions.”

“Covid has resulted in unexpected difficulties for many businesses. It is often difficult to assess which companies are working hard given the resting significant background noise. Also, the ability to actively engage in times of WFH / online AGMs has declined significantly.”

“Valuations have come down and have made certain assets more favorable from a risk/reward perspective. Additionally, every activist likes to benefit from market tailwinds.”

“It has created more opportunities for activists, an example is Virtusa, where the activist loaded up on cheap stock at the time of the March sell-off. It turned the opportunity into a home-run return for the activist.”

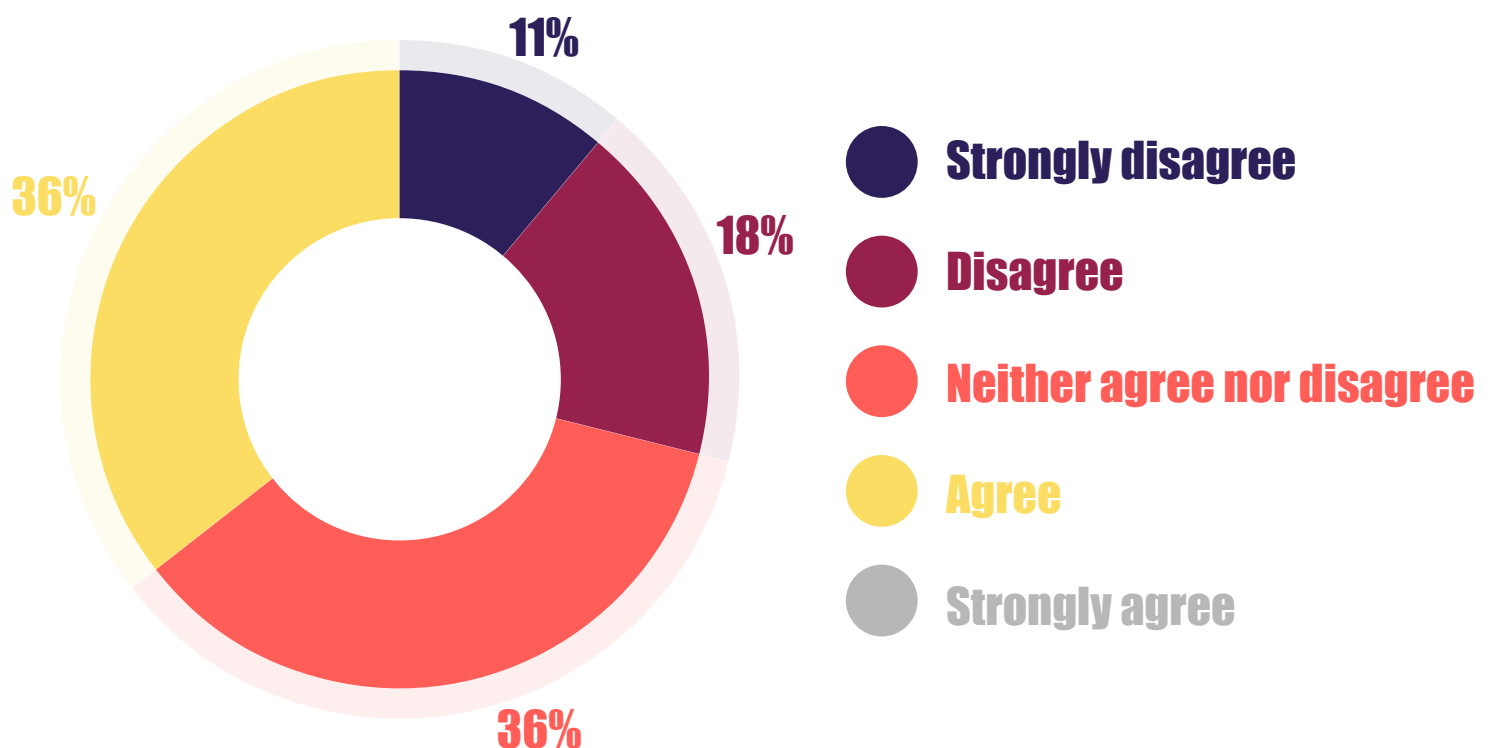
(Anonymous respondent comments)

While COVID-19 caused a slowdown in the first part of 2020, partially because it hit major financial markets at the beginning of annual meeting season, many activists believe that the pandemic will have a negligible or positive impact on activism by identifying laggards and poorly managed companies.

WHAT'S CHANGED?

To what extent do you agree with the following statements:

“Activism is becoming crowded in the U.S. and targets are becoming increasingly hard to find.”



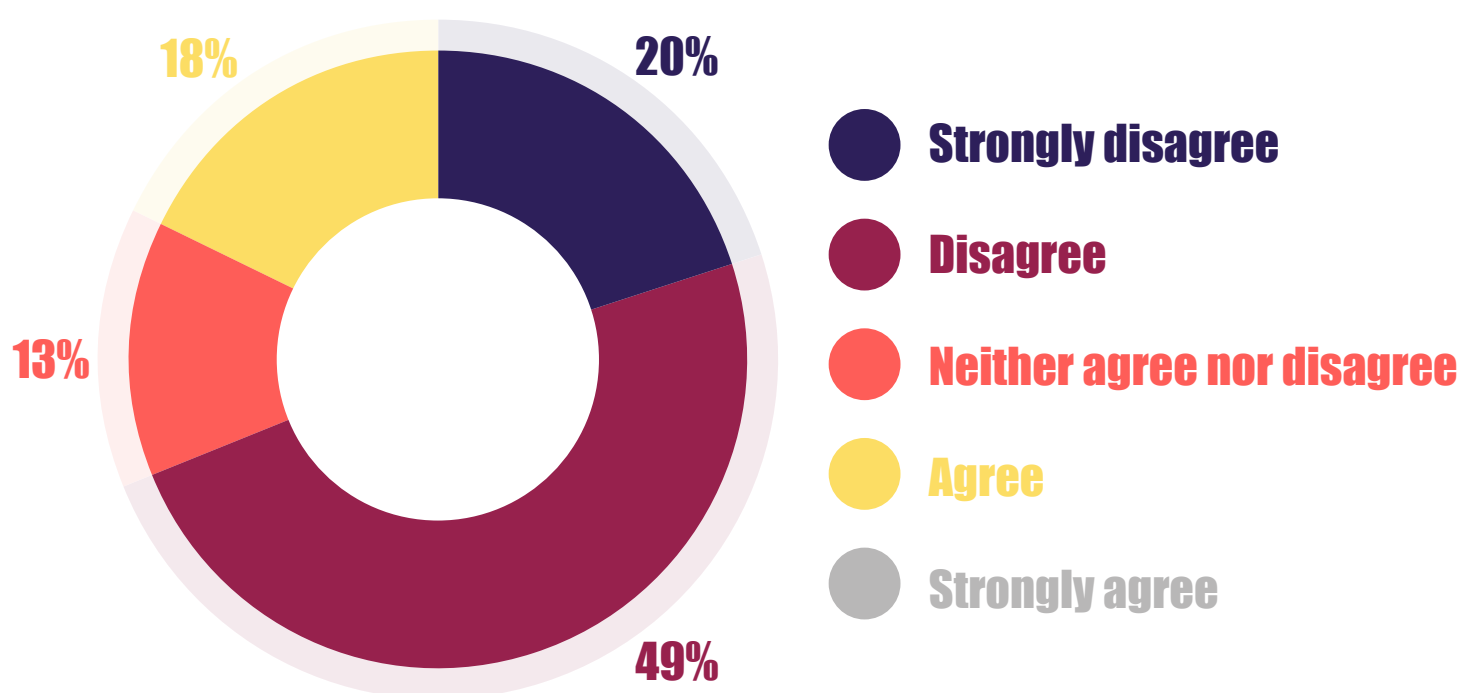
In the 2018 edition of this survey, 33% of respondents agreed with this statement. By late 2020, the proportion of respondents agreeing that activist targets were hard to find in the U.S. had risen slightly to 36%.

Moreover, only 29% disagreed with the statement this year, down from 39% expressing some degree of disagreement in 2018. Following a significant rebound in valuations after the first quarter, the market is perhaps more challenging for activist investors heading into 2021.

“There have been reports that shareholder activism in the U.S. has declined since the start of the year. It will be interesting to see what happens as the pandemic wanes, the administration changes and markets respond.”

**Marc Weingarten,
Schulte Roth & Zabel**

“Increased engagement by institutional investors with portfolio companies will decrease the role of activist investors.”



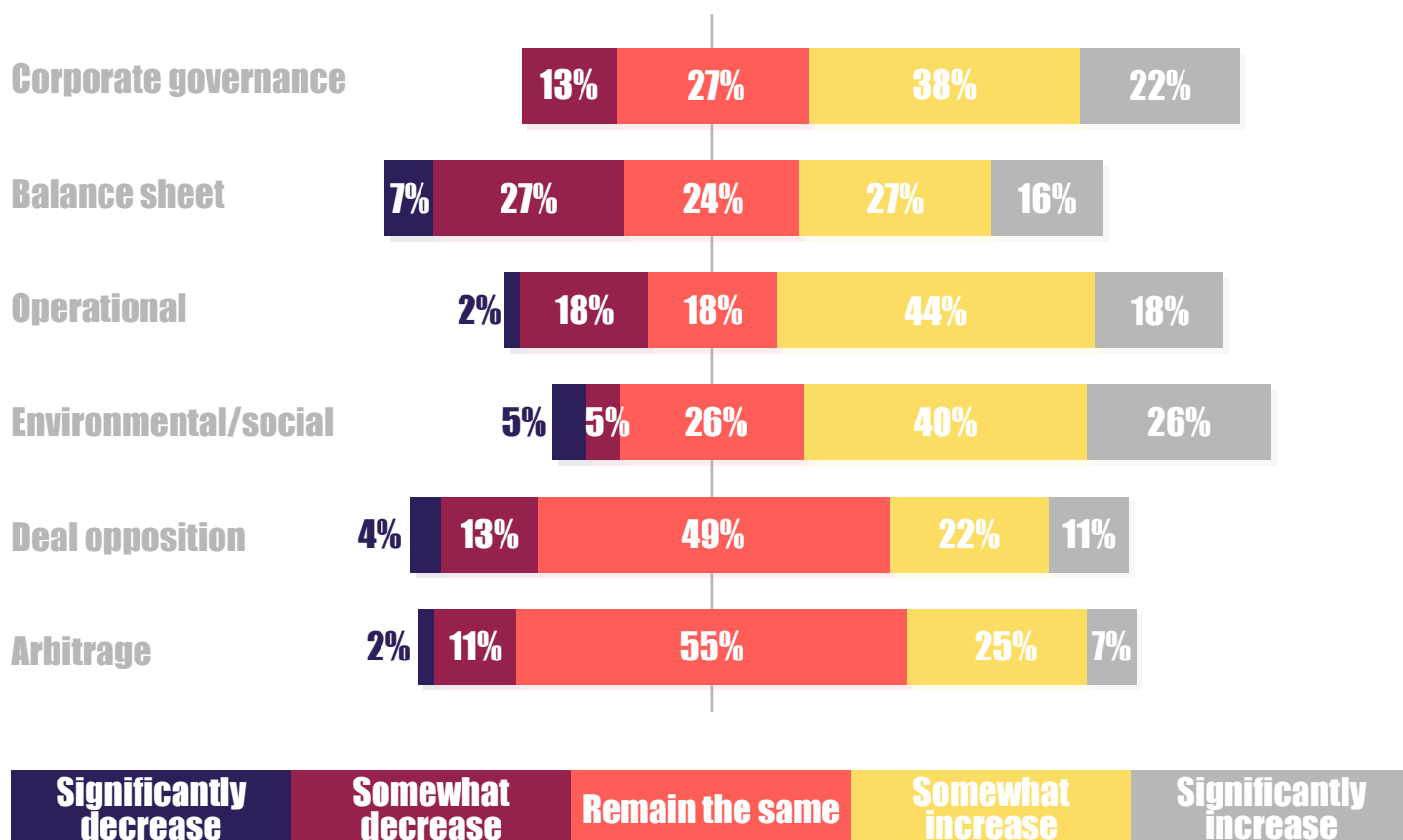
By now, increased engagement from institutional investors is nothing new. However, the proportion of respondents disagreeing with this statement has decreased from 80% in 2018 to 69% in 2020 and 18% agree. Forcing companies to explain their purpose and strategy appears to make them less vulnerable to activist campaigns.

“Activists can better harness the increased engagement of institutional investors to drive change.”

Bruce Goldfarb, Okapi Partners

NEW VULNERABILITIES

For the following types of shareholder activism, what are your expectations for the amount of each type over the next 12 months?

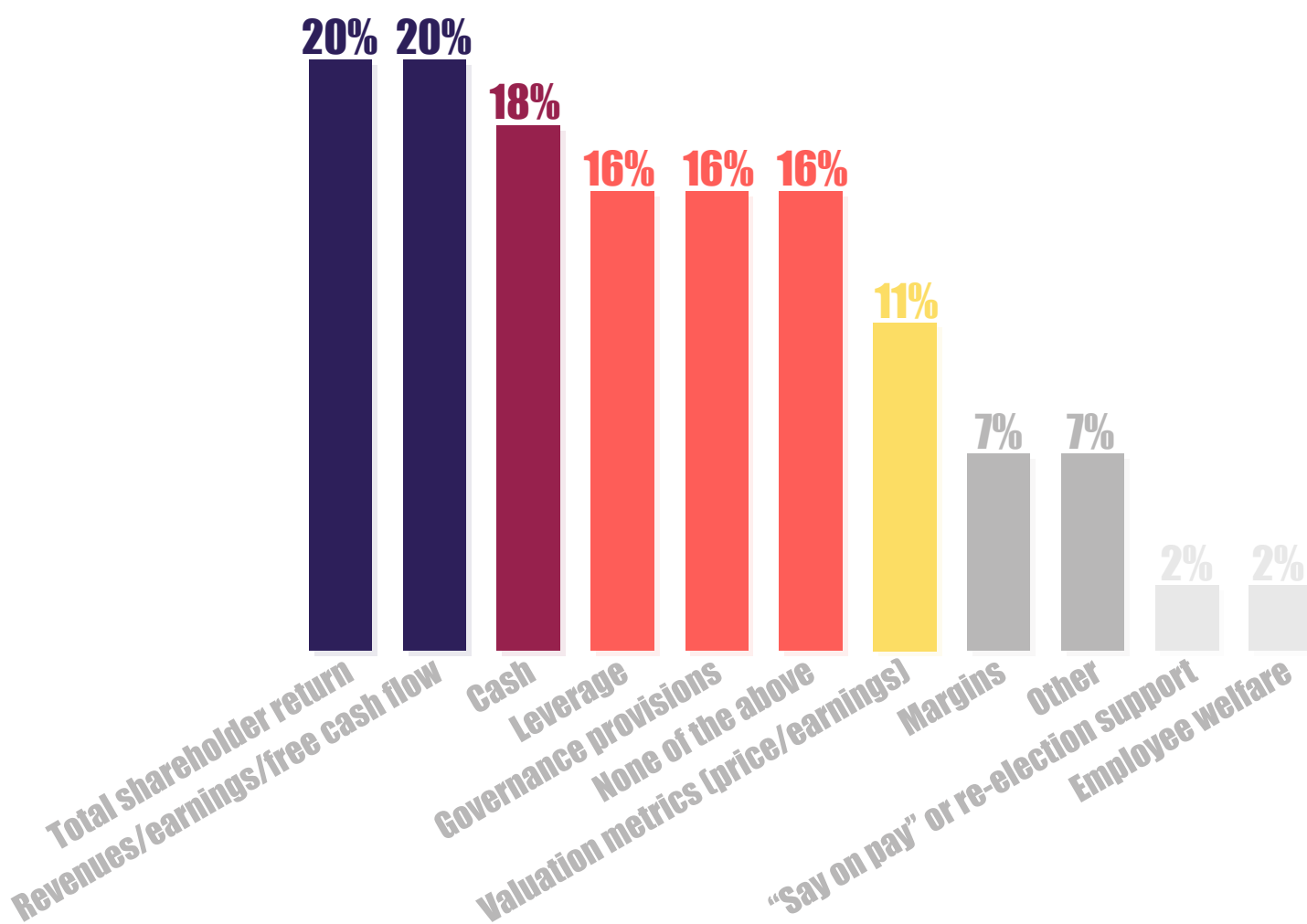


From the third-highest rank in 2018 to first in 2020, environmental and social activism looks like it will continue to gather pace. With lockdowns hurting cash flows, balance-sheet activism is set to be a tough sell. But operational activism continues to be a major area of opportunity in the eyes of activists.

“Activists expect more environmental and social activism compared with our 2018 survey. Expectations for balance sheet and operational activism have shrunk.”

Josh Black, Activist Insight

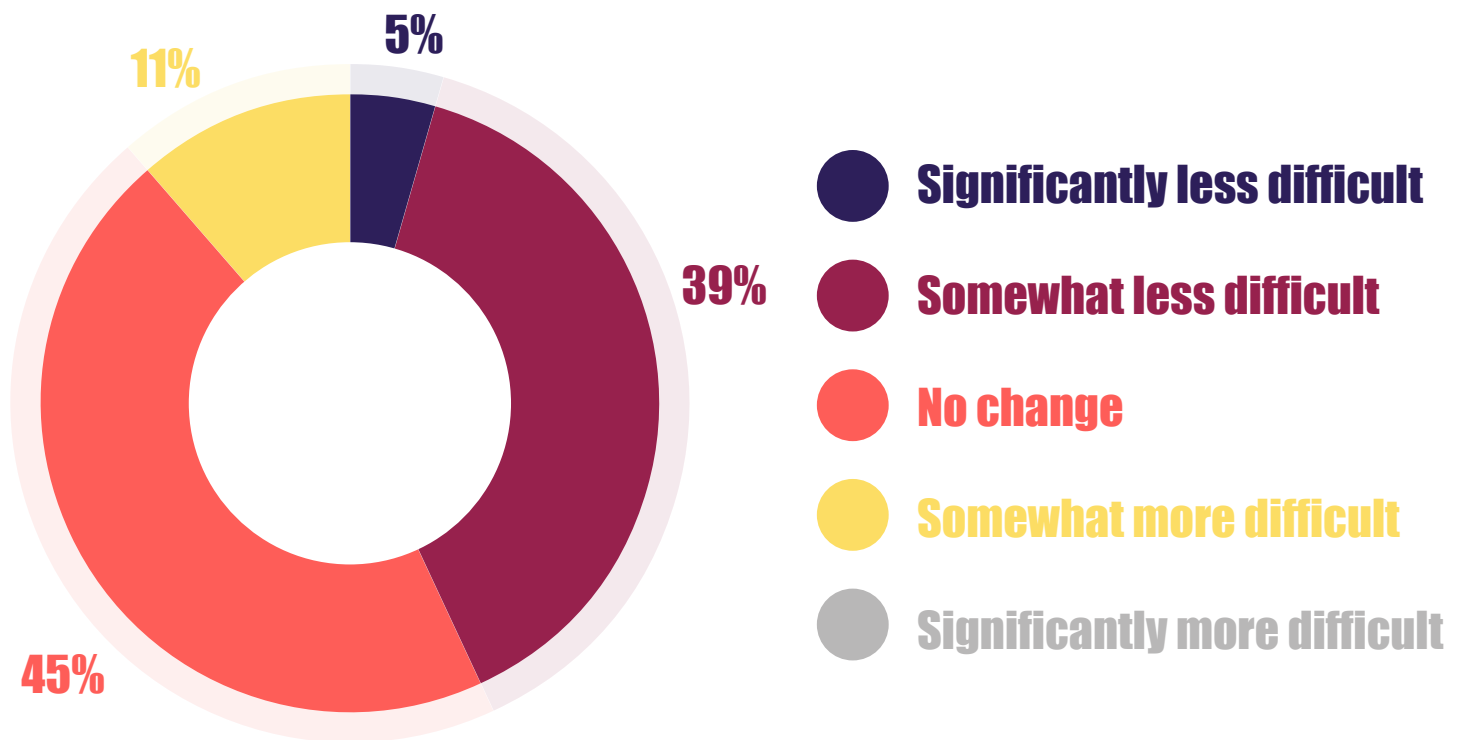
Which screening options have become more important to you over the past 12 months?



Proportion of respondents who thought the screening option had become more important in the past 12 months.

Financial and operating performance remains the primary target of diligence for activist investors. Interestingly, valuation has slipped down the rankings, while employee welfare and the ability of company employees to work from home has not yet become a major factor in investment decisions.

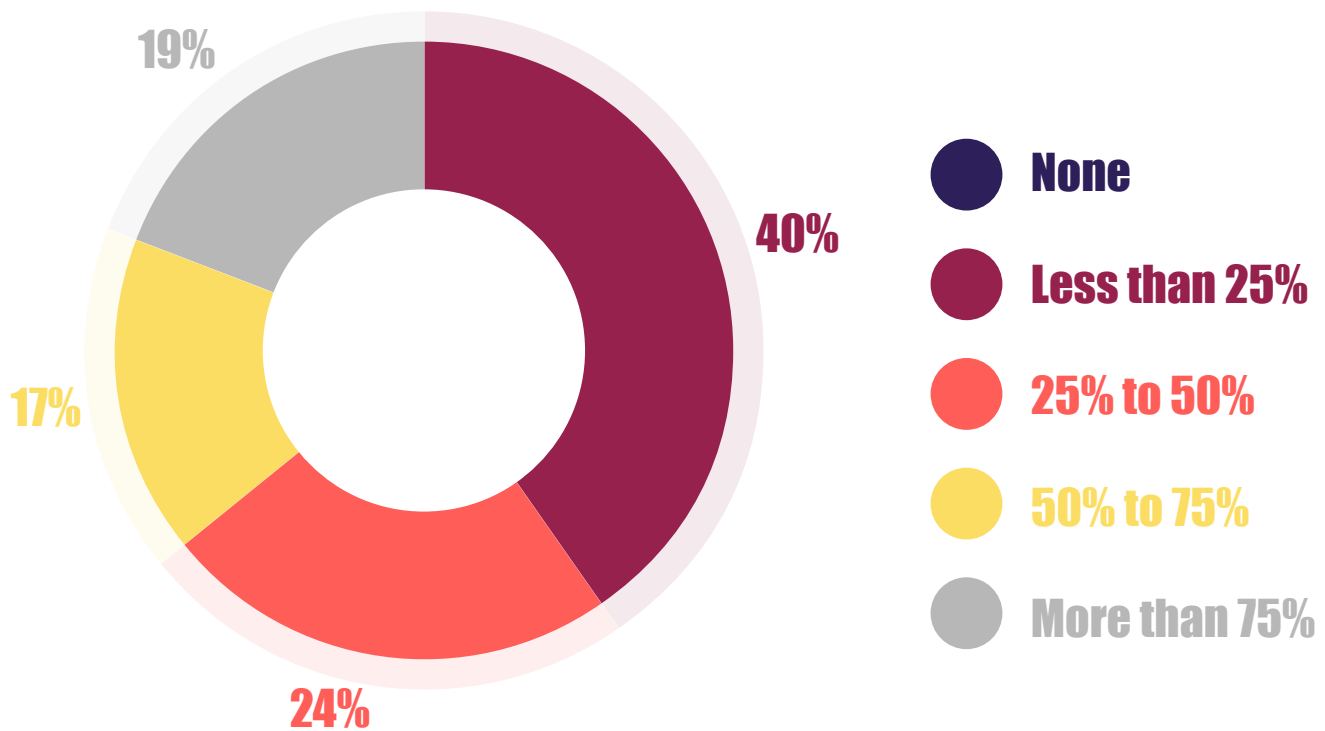
Compared to previous years, how difficult is it currently for activist investors to reach settlements with management teams?



“In the past year, there has been a rise in ‘handshake settlements.’ For activists, this has been a positive development. The absence of formal agreements has allowed investors to avoid standstill restrictions while effecting change.”

Aneliya Crawford, Schulte Roth & Zabel

Roughly what proportion of your campaigns enter the public domain?

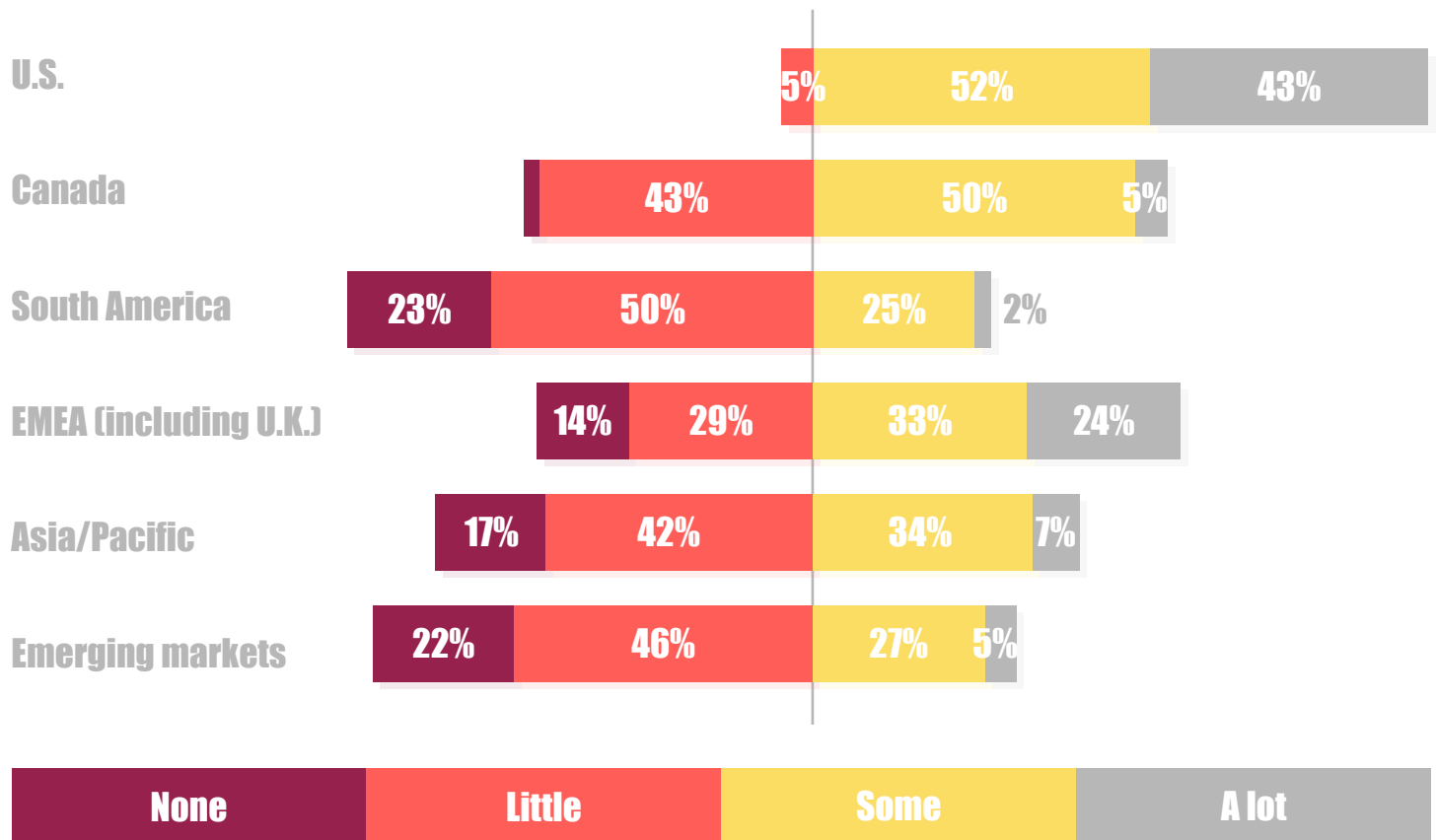


“Investors frequently use the public domain to shine a light on an underperforming company. In the right circumstance, a behind-the-scenes approach can be more effective. In fact, a significant number of the campaigns we were involved in did not enter the public domain.”

Michael Swartz, Schulte Roth & Zabel

WHERE IN THE WORLD?

For shareholder activism, how much opportunity do you anticipate in the following regions?



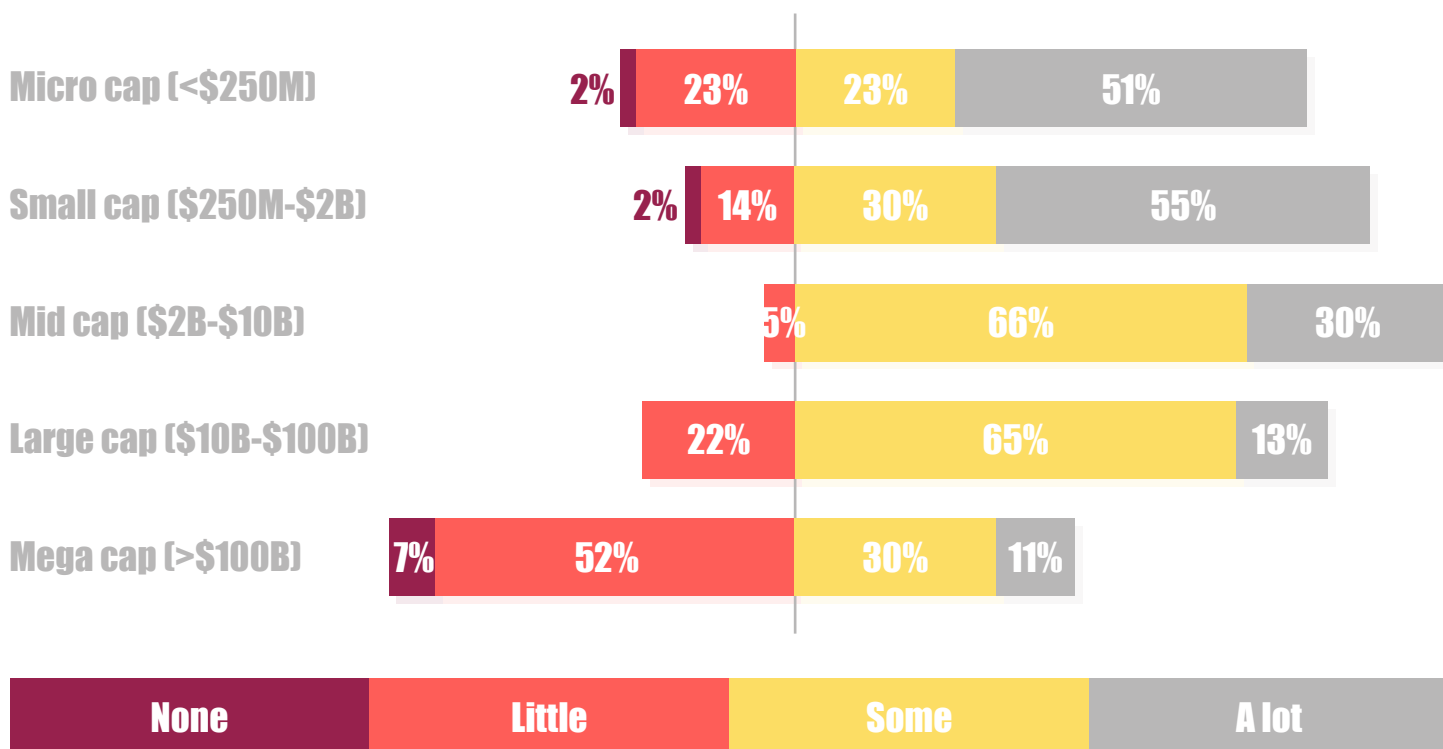
Nearly one-quarter of respondents told us in their responses to a separate question that they were considering an activist investment in the U.K. in the next 12 months, a surprisingly high number. Japan was cited by fewer respondents than Germany or France, while Australia took second place in the list of non-U.S. markets where campaigns were being planned.

“In the United Kingdom and continental Europe, we have seen companies being held to task by climate activists in the form of shareholder proposals. We can expect that trend to continue as investors, more and more, are demanding ESG-driven changes.”

Jim McNally, Schulte Roth & Zabel

MARKET CAP

For shareholder activism, how much opportunity do you anticipate in the following market-cap ranges?



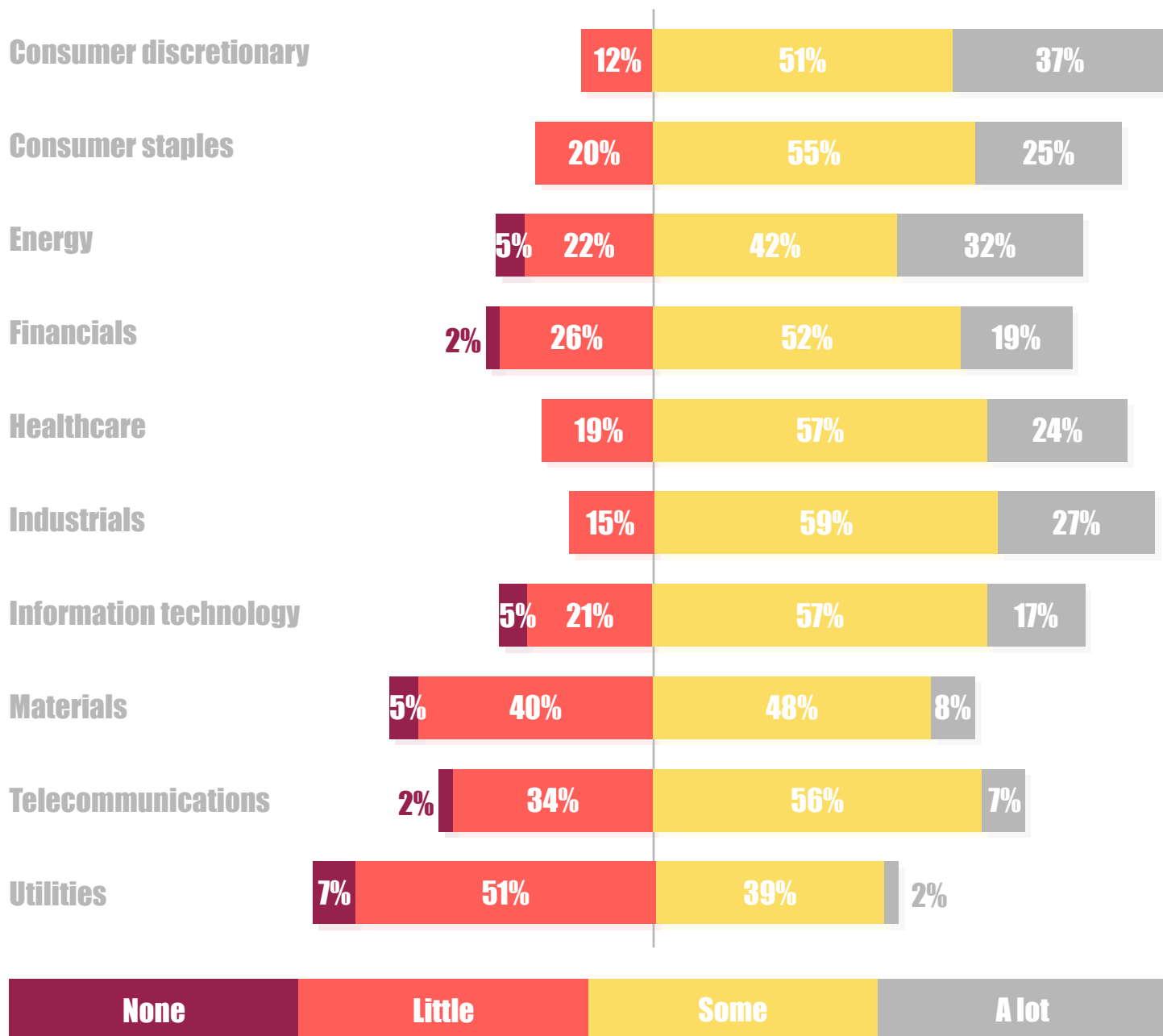
Increased optimism is most notable at the larger end of the market-cap spectrum, when compared with our 2018 survey. Then, no respondents said there was a lot of opportunity in large- or mega-cap companies. Although high levels of enthusiasm are less pronounced at smaller companies, there is some opportunity in all areas of the market.

“Activists see opportunities with both smaller companies that may be more affected by the pandemic and larger ones that may have the wherewithal to change course.”

Josh Black, Activist Insight

SECTOR

For shareholder activism, how much opportunity do you anticipate in the following sectors?



Key campaigns launched since the COVID-19 pandemic

INDUSTRIALS

Activists: Senator Investment Group & Cannae Holdings
Company: CoreLogic
Date of campaign: June 2020
Demands: Takeover, proxy contest

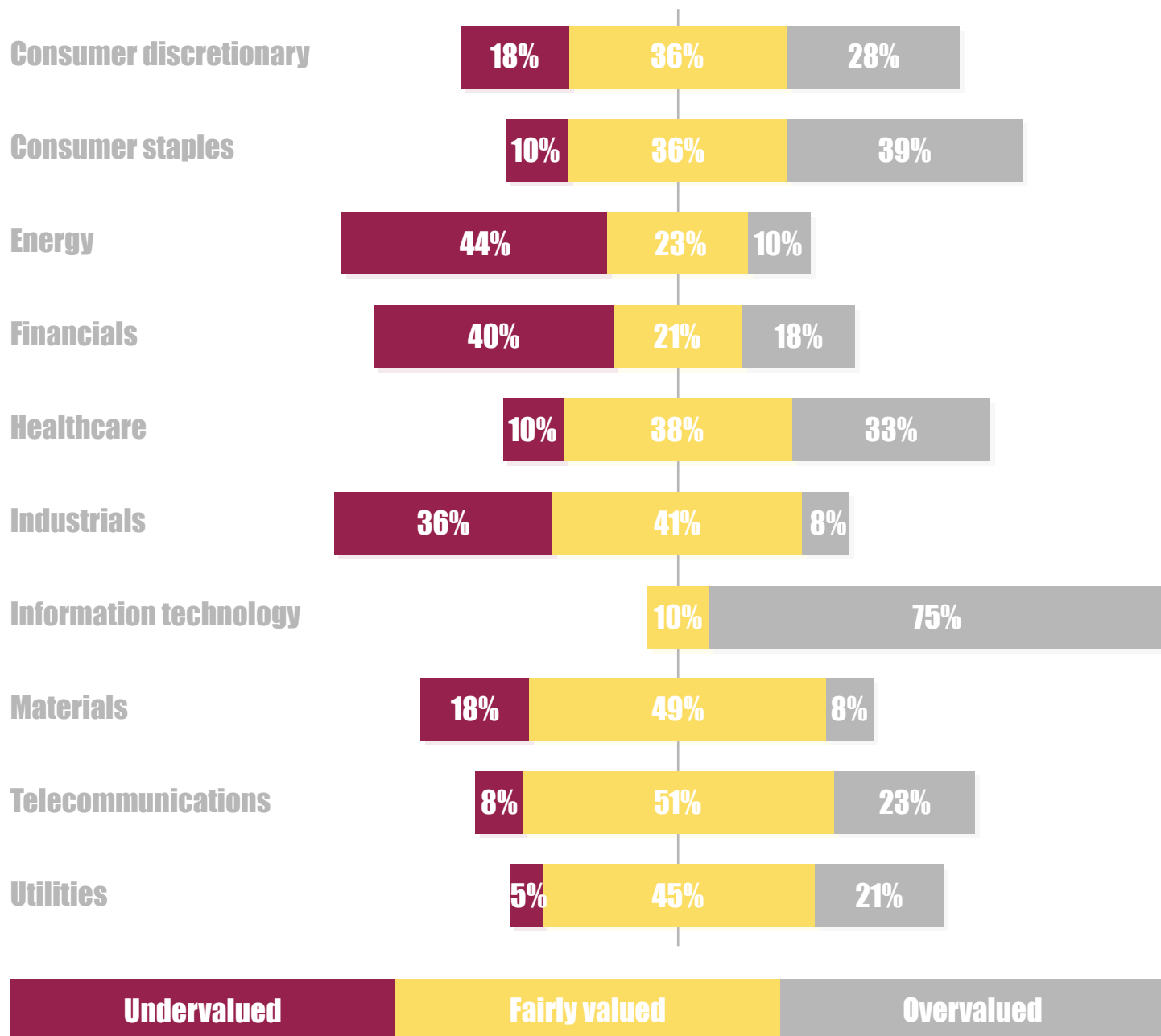
HEALTHCARE

Activist: Sian Capita
Company: Opko Health
Date of campaign: October 2020
Demands: Cut costs, push for sale

ENERGY

Activist: Elliott Management
Company: Noble Energy
Date of campaign: September 2020
Demand: Oppose sale

Within each sector, how do you view current market valuations?



The remainder of respondents in each of the categories replied 'Don't know.'

FINANCIALS

Activist: Trian Partners

Company: Invesco

Date of campaign: October 2020

Demands: Board seats, push for merger

CONSUMER CYCLICAL

Activist: Biglari Holdings

Company: Cracker Barrel Country Stores

Date of campaign: August 2020

Demand: Board seats

CONSUMER STAPLES

Activist: Veraison Capital, Cobas Asset Management

Company: Aryzta

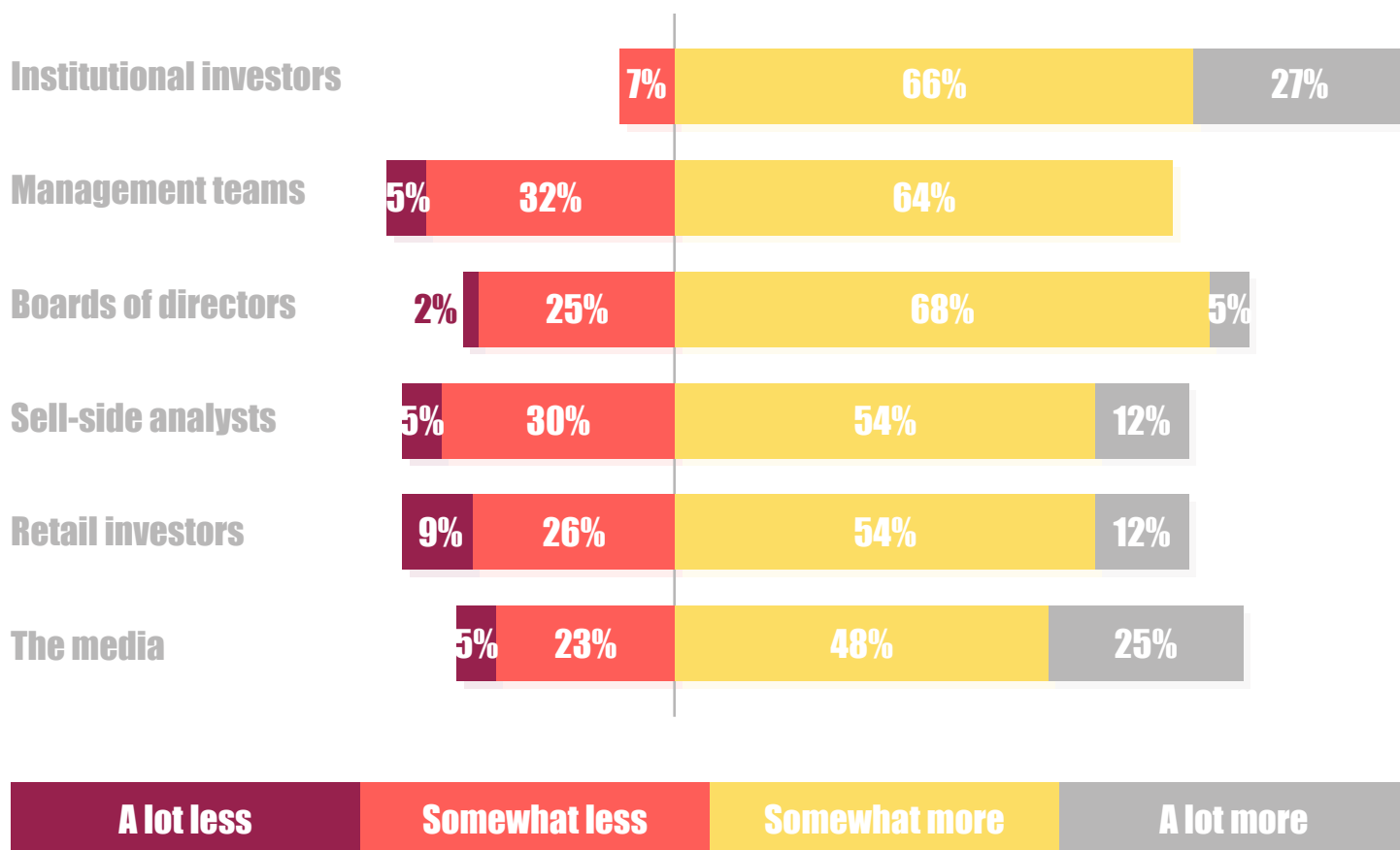
Date of campaign: May 2020

Demands: Push for sale, proxy contest

Source: Activist Insight Online

NEW FRIENDS

Compared to previous years, how accepting have the following stakeholders become of activist investors in the past 12 months?



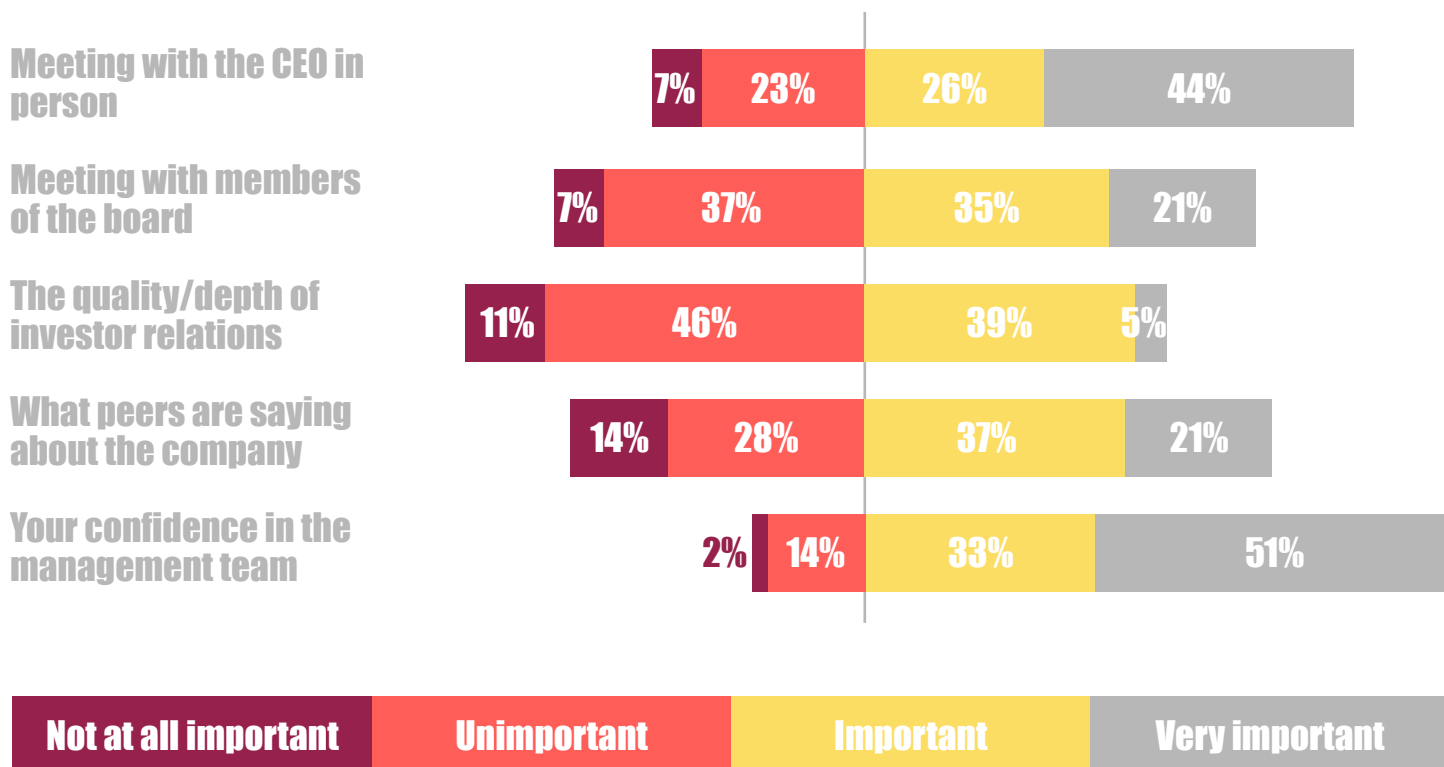
The proportion of activists saying settlements had become more difficult to come by fell from 17% to 11% between 2018 and 2020 as most stakeholder groups have continued to become more accepting of their role in aggregate. However, this year's survey found much bigger proportions believed each group had become less accepting of activists. The only one that hadn't was institutional investors - perhaps the most important in activists' eyes.

"Across the board, shareholder activism has become an important part of the capital markets."

Bruce Goldfarb, Okapi Partners

FIRST IMPRESSIONS

When conducting due diligence on a potential investment for the first time, how important are the following to forming your opinion about the company?



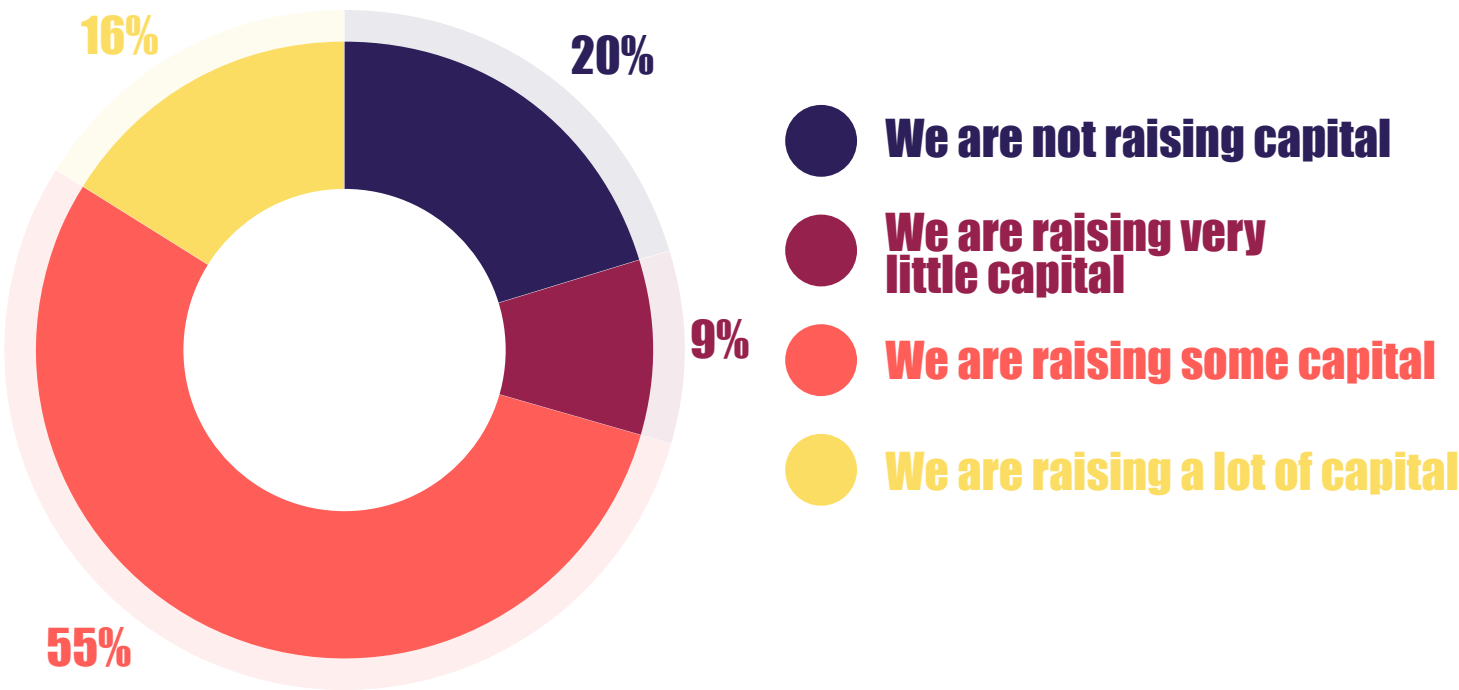
Activists are more skeptical about the future allocation of capital to dedicated activist strategies, with 69% of respondents in 2020 expecting a decline in overall assets (see p.22). Only 14% of respondents in 2018 thought capital deployed in activism would decrease. Activists raising some or a lot of capital fell from 72% to 31% in that period.

“Due diligence is an interesting skill set that partially explains market forces behind the convergence of shareholder activism, private equity and PIPEs. The different investors across the spectrum of these investment classes have similar research and due diligence capabilities to evaluate prospective target companies.”

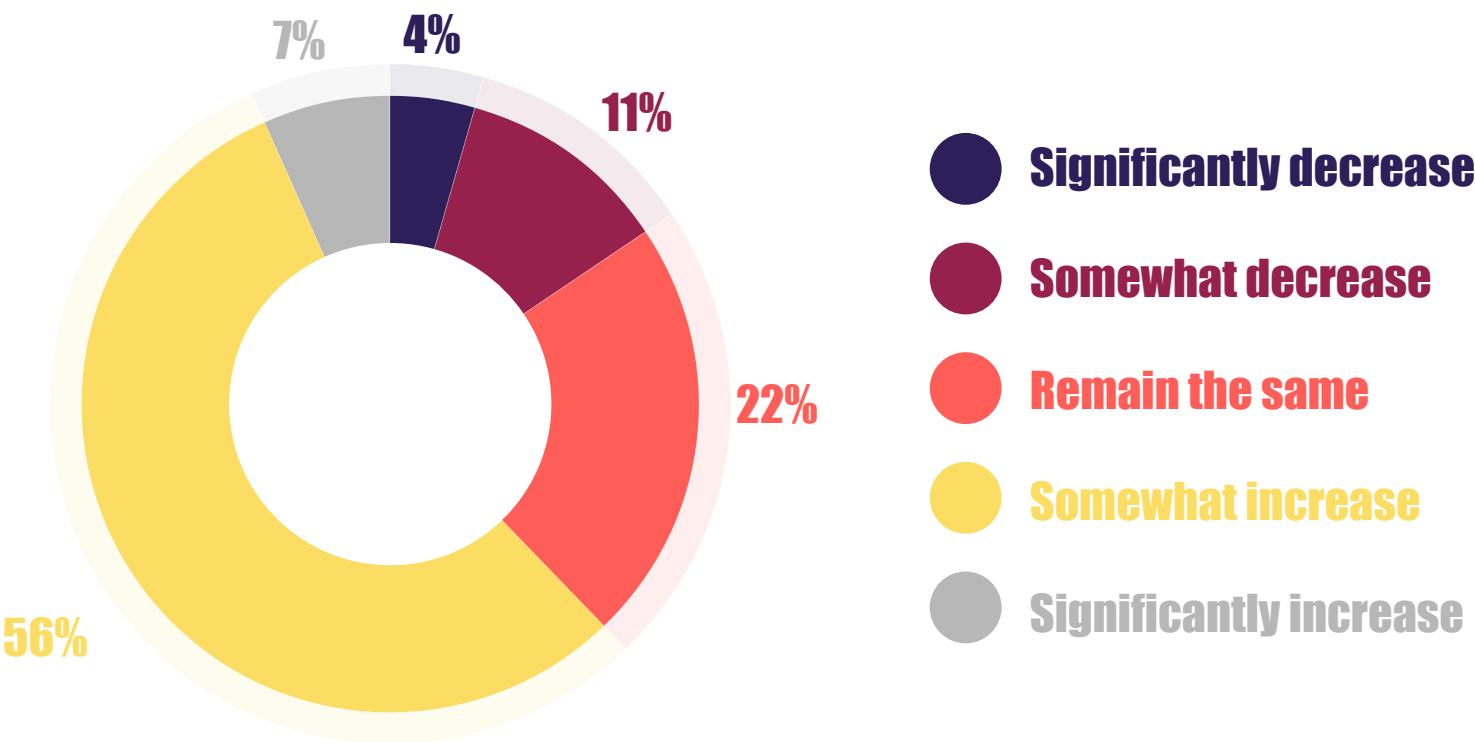
Ele Klein, Schulte Roth & Zabel

FUNDRAISING

For the capital you manage, what are your expectations for raising new capital over the next 12 months?



Capital deployed in shareholder activism has grown significantly over the last few years. Relative to the pace of current growth, how do you anticipate the assets allocated to activist strategies will change over the next 12 months?





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About Insightia/Activist Insight

Financial news and data providers Activist Insight and Proxy Insight announced in October 2020 that they had merged to form Insightia, a leader in the field of public company information. Since 2012, Activist Insight (www.activistinsight.com) has provided its diverse range of clients with the most comprehensive information on activist investing worldwide. Regularly quoted in the financial press, Activist Insight is the trusted source for data in this evolving space and offers a range of modules including: *Activist Insight Online*, *Activist Insight Governance*, *Activist Insight Vulnerability*, *Activist Insight Shorts*, *Activist Insight Monthly* magazine, and *The Activist Insight Podcast*. Proxy Insight has quickly become the world's leading source of information on global shareholder voting, covering such hot topics as director and auditor elections, "say on pay" resolutions and environmental, social, and governance (ESG) proposals.

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