May 26, 2016

Corporate Governance Update: Holding Activists and Proxy Advisory Firms Accountable?

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and
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The nation's capital is center stage for the latest round of debates as to the impact of shareholder activism on American business. With the introduction of the Brokaw Act by four Democratic senators in March, followed by the announcement in May of a new D.C.-based lobbying organization formed by a bipartisan group of prominent hedge fund activists, the long-running controversy over the unprecedented influence of shareholder activism has officially reached Washington. The hedge fund activist agenda now includes public policy, and it appears that the influence of these powerful investors is to be wielded on K Street as it has been on Wall Street. By raising their own profile via a Washington-based lobbying entity, such activists will place themselves and their business practices squarely in the spotlight. Perhaps a more significant public presence will engender a more favorable reputation for activists, or perhaps it will increase activist accountability to lawmakers and public shareholders; or, perhaps, it will do both.

At the same time, lawmakers are taking significant steps toward much-needed regulation of proxy advisory firms. With a bipartisan bill introduced this week, Congress outlined a comprehensive oversight framework for increasing the transparency and accountability of proxy advisory firms.

Rising Activism Concern

The immense financial power of activist investors and their aggressive attacks on corporations have caused concern on Capitol Hill. Last month, Pershing Square's William Ackman was called to testify before a Senate committee regarding his investments in Valeant Pharmaceuticals International, as well as his involvement in Fannie Mae, Freddie Mac, and Herbalife. Valeant's notorious strategy of drug acquisitions and massive price increases while dismissing the value of R&D had yielded higher shareholder value (for a time) but inflicted extortionate costs on hospitals and patients. During the high-profile hearings, both Democratic and Republican senators

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expressed outrage at the practices, which were disavowed by Ackman and outgoing Valeant CEO Michael Pearson.[1]

The Valeant hearings took place just one month after the Brokaw Act was introduced in the Senate to curb abuses of outdated disclosure laws by activist investors. Co-sponsoring Senator Tammy Baldwin (D-Wis.) had strong words directed at activists: "We cannot allow our economy to be hijacked by a small group of investors who seek only to enrich themselves at the expense of workers, taxpayers and communities."[2] Named after a small town in Wisconsin that was bankrupted by the closing of a plant after activists targeted the company, the Brokaw Act is intended to expedite and broaden required disclosures of activity in target company stock.[3]

The Brokaw Act would direct the U.S. Securities and Exchange Commission to amend the Section 13(d) reporting rules in several key ways. First, the Brokaw Act would reduce the 10-day filing window for an initial Schedule 13D filing to two business days. Second, it would require the disclosure of short positions over 5 percent on Schedule 13D. Third, it would expand the definition of beneficial ownership to include a direct or indirect pecuniary interest, in addition to voting or dispositive power. Investors would therefore have to include shares held in swaps and other cash-settled derivatives, not merely equity securities or securities convertible into equity securities. Fourth, the Brokaw Act would specifically require the disclosure of activity by hedge funds and groups of hedge funds under Section 13(d). The explicit inclusion of hedge funds in the definition of "persons" is a signal that the SEC is directed to pay close attention to activists and to "wolf pack" activity intended to evade the disclosure requirements. These four amendments would significantly increase the transparency and fairness of the disclosure rules, closing loopholes that are routinely exploited by activists and other sophisticated investors. The proposed revisions would result in higher quality information released in a timelier fashion, to the benefit of the public equity markets.[4] Although the Brokaw Act does not go far enough to close all of the loopholes available to activists, it would be a significant step forward.

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[1] *See* Cynthia Koons & Anna Edney, "Ackman, Valeant Offer Apologies, Concessions at Drug Hearing," Bloomberg.com, April 27, 2016, available at http://www.bloomberg.com/news/articles/2016-04-27/valeant-s-regrets-may-not-appease-senators-at-drug-price-hearing.

[2] *See* Donna Borak & David Benoit, "Democrats Take Aim at Activist Investors," WSJ.com, March 17, 2016, available at http://www.wsj.com/articles/democrats-take-aim-at-activist-investors-1458251491.

[3] The text of the proposed legislation is available at https://www.baldwin.senate.gov/imo/media/doc/3.17.16%20-%20Brokaw%20Act%20Final.pdf.

[4] Wachtell, Lipton, Rosen & Katz has consistently advocated for modernization of the reporting regime. See Theodore N. Mirvis, et al., "Legislation Calls for Important Revisions to 13(d) Beneficial Ownership Reporting Rules," WLR&K Memorandum, March 18, 2016, and citations linked therein. The memorandum is available at http://www.deallawyers.com/member/docs/firms/Wachtell/03_16_reform.pdf.

The Brokaw Act was introduced by Senator Baldwin along with Senator Jeff Merkley (D-Ore.) and co-sponsored by fellow Senators Elizabeth Warren (D-Mass.) and Bernie Sanders (D-Vt.). As election-year legislation that happened to be sponsored by Democrats in the Republican-controlled Senate, the Brokaw Act may be unlikely to be enacted in the foreseeable future, even though its proposed reforms are nonpartisan and offer wide-ranging benefits. Just as senators on both sides of the aisle joined to condemn Valeant's business practices in the April hearings, Republicans and Democrats should unite to support this modernizing legislation.

Activists Respond

Earlier this month, a new lobbying effort was announced by a group of activist investors. The Council for Investor Rights and Corporate Accountability (CIRCA) is "committed to promoting the actions of shareholder activists, and their positive impact on corporate governance and business policies at publicly traded companies."[5] In other words, the organization will advocate for activists' interests in Washington and generally seek to further the hedge fund activist agenda, including by making the case that shareholder activism benefits publicly traded companies, their shareholders, and by extension, the economy in general. CIRCA reportedly is a coordinated effort by Ackman, Carl Icahn, Daniel Loeb of Third Point, Paul Singer of Elliott Management, and Barry Rosenstein of JANA Partners.[6] These investors manage roughly $90 billion of assets and have publicly targeted a wide range of well-known companies, with varying results.

CIRCA clearly is intended to counter the anti-activist momentum that has been gathering among lawmakers and market participants alike. This is not the first such effort; in 2008, Carl Icahn established the "United Shareholders of America" group, which was intended to be "a voice for large and small shareholders … in Washington to combat pro-management forces."[7] The "U.S.A." as it was known, seems to have been a relatively short-lived effort that has been subsumed into Icahn's personal endeavors. CIRCA, by contrast, appears to be a higher-profile and more ambitious effort.

In Washington, the Valeant hearings, the proposed Brokaw Act, and the presidential campaign rhetoric in this election cycle no doubt have left activists feeling increasingly vulnerable to the possibility of legislation unfavorable to their interests. On Wall Street, criticism from prominent institutional investors of activists' "short-termism" and collusive tactics have put activists on the defensive. Last year, BlackRock chairman

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[5] *See* Reuters, "Activist Investor Heavyweights Form New Lobbying Arm," May 18, 2016, available at http://www.reuters.com/article/us-usa-activist-lobbying-idUSKCN0Y92YV.

[6] *See* David Benoit, "Activist Investors Have a New Target: Washington," WSJ.com, May 18, 2016, available at http://www.wsj.com/articles/activist-investors-ally-to-form-lobby-group-1463604738.

[7] *See* Peter Galuszka, "Icahn Launches the United Shareholders of America," CBS.com, October 13, 2008, available at http://www.cbsnews.com/news/icahn-launches-the-united-shareholders-of-america/.

and chief executive Larry Fink pointed to "the proliferation of activist shareholders seeking immediate returns" as a significant concern for companies trying to build long-term value,[8] and the Conference Board's seminal October 2015 report, "*Is Short-Term Behavior Jeopardizing the Future Prosperity of Business?*" also identified activist hedge funds as a key driver in short-term behavior. The activist investors behind CIRCA had been discussing for several years the possibility of forming an organization, reportedly prompted by the formal petition for amendments to the Section 13(d) disclosure requirements submitted to the SEC by Wachtell, Lipton, Rosen & Katz in 2011, and with CIRCA they have now formalized their efforts.[9] According to news reports, the organization intends to eschew political action and focus on convincing policy makers and the public that their activities create value for shareholders generally.

Activists and Accountability

Shareholder activists often claim to be a countervailing force against the power of entrenched boards of directors. According to a CIRCA representative, "CIRCA was founded on the widely accepted idea that a well-functioning system of checks and balances between boards of directors and shareholders is fundamental to long term economic growth and U.S. prosperity."[10] Activists assert that their demands for change in corporate strategy, management, board composition, and other elements of corporate governance serve to hold boards accountable for their decisions and performance. CIRCA's mission appears to be to convince lawmakers and the public that activists serve the public good.

The activist lobby is likely to have something of an uphill battle. In the populist, anti-financial-industry mood of the moment, exacerbated by the rhetoric of presidential candidates, investors such as these are viewed as predators rather than protectors of the investing public. Moreover, thoughtful and influential leaders continue to point to activists as inimical to worthwhile corporate goals. Larry Fink's February 2016 letter to S&P 500 chief executives encouraged companies to clearly articulate long-term plans for value creation as a defense against the superficially attractive but typically short-term visions of activists.[11] In the same vein, Leo E. Strine, chief justice of the Delaware Supreme Court, observed in March 2016 that, all too frequently, companies faced with activist attacks suddenly change their corporate strategy rather than staying with a pre-existing business plan that has been regularly and deeply reviewed by the

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[8] Larry Fink's 2015 letter is available at http://www.businessinsider.com/larry-fink-letter-to-ceos-2015-4.

[9] *See* Benoit, *supra*. Wachtell, Lipton, Rosen & Katz's 2011 petition to the SEC is available at https://www.sec.gov/rules/petitions/2011/petn4-624.pdf.

[10] *See* Reuters, *supra*.

[11] Larry Fink's 2016 letter is available at http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2.

board and senior management.[12] Chief Justice Strine has written in recent years about the dangers of short-term investors' dominating corporate decisionmaking and has advocated for the creation of a system that will employ shareholders' rights in a way "that is more beneficial to the creation of durable wealth for them and for society as a whole."[13]

Taking an optimistic look ahead, it is just possible that activist lobbying may end up creating a situation in which activists are compelled to change their practices for the better. Making the public case for activism runs the risk of drawing more negative attention to activists' enormous financial power, unscrupulous tactics, and mixed records of successes and failures. In trying to demonstrate that they hold boards accountable and benefit the American economy, activists may find that they themselves are held more accountable than ever before. And, just as Ackman found himself repudiating the controversial business practices of Valeant under the glare of the Senate hearings, activists engaged in public dialogue with lawmakers and other leaders may find themselves renouncing some of their more egregious, short-termist tactics. To the extent that activists attempt to style themselves the champions of Main Street investors, they will feel pressure to defend, mitigate, or abandon their obviously self-serving activities.

The dynamics of a meaningful activist lobbying effort will be interesting to observe. It certainly could be a welcome development if it leads somehow to a greater focus by activists, other investors, and corporations alike on strategic planning and meaningful long-term value creation. Perhaps unlikely, nonetheless such an outcome would indeed represent a "positive impact" of activist efforts on Wall Street, Main Street, and the American economy.

Regulation of Proxy Advisory Firms

Another bill, introduced in the House of Representatives on May 24, 2016, aims to create an oversight framework for proxy advisory firms such as ISS and Glass Lewis.[14] The Corporate Governance Reform and Transparency Act of 2016 (initially titled the Proxy Advisor Firm Reform Act of 2016), introduced by Rep. Sean Duffy (R-Wis.) and Rep. John Carney (D-Del.), would require proxy advisory firms to register with the SEC. As part of the registration process, a firm would have to certify that it has adequate financial and managerial resources to consistently and accurately provide proxy voting advice. It would also be required to provide information regarding its procedures

[12] See Michael J. de la Merced, "Delaware's Chief Justice Speaks out on Big Mergers and Investors," NY Times Dealbook, March 17, 2016, available at http://www.nytimes.com/2016/03/18/business/dealbook/delawares-chief-justice-speaks-out-on-big-mergers-and-investors.html.

[13] Leo E. Strine, Jr., "Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law," Essay, 114 Columbia L.R. 449, 476, Jan. 31, 2011, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2421480#.

[14] The text of the bill can be found at Corporate Governance Reform and Transparency Act of 2016.

and methodologies, its organizational structure and whether it has a code of ethics. In addition, addressing a widespread concern, a proxy advisory firm would have to disclose any potential or actual conflicts of interest created by its ownership structure and the services it provides to clients, including whether it engages in consulting services for companies, and the policies and procedures in place to manage conflicts that may arise in this context. Under the proposed legislation, the SEC would be directed to prohibit or regulate conflicts of interest arising from the provision of proxy advisory services in a variety of contexts.

Under the proposed legislation, registered proxy advisory firms would have to file an annual report with the SEC containing information on the number of shareholder proposals reviewed in the past year, the number of recommendations that were made, how many employees reviewed the proposals, and how many of the proposals were sponsored by clients of the proxy advisory firm. Proxy advisory firms also would be required to file and make publicly available their policies regarding the formulation of their proxy voting policies and voting recommendations. The bill would give corporations the right to review and comment on a proposed recommendation by a proxy advisory firm before the recommendation is provided to investors. Corporations would have a private right of action against a proxy advisory firm that did not provide this opportunity. Finally, registered proxy advisory firms would be required to appoint an internal compliance officer.

This bill would represent a significant step toward much-needed oversight of unduly influential proxy advisory firms. It would dramatically increase transparency and improve accountability, going well beyond the scope of the SEC's 2014 Staff Legal Bulletin No. 20. The issuance of SLB 20 followed a concept release and roundtable by the SEC and addressed several important issues relating to proxy advisory firms. SLB 20 clarified the duties and obligations of proxy advisors and of investment advisors that rely on proxy advisors' services. Still, more is needed, and as former SEC Commissioner Daniel Gallagher noted in his testimony before the House Financial Services Committee on May 17, the proposed legislation "would pick up where SLB 20 left off by providing a comprehensive regulatory regime to address many of the fundamental concerns that still remain regarding the activities of proxy advisers."[15]

Increased accountability for activists and for proxy advisory firms would be highly beneficial to corporate America. It is to be hoped that Congress will give the Brokaw Act and the Proxy Advisory Firm Reform Act full and fair hearings and that, ultimately, bipartisan support for both bills will result in a significantly improved regulatory environment for both investors and public companies.

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[15] Testimony of Daniel M. Gallagher before the U.S. House of Representatives Committee on Financial Services, "Legislative Proposals To Enhance Capital Formation, Transparency, and Regulatory Accountability," May 17, 2016, at 11.

FINANCIAL TIMES

April 23, 2014 5:56 pm

Shareholder activism: Battle for the boardroom

By Stephen Foley

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Fearless investor advocates or opportunists? The legal landscape is shifting in their favour

Martin Lipton, the Wall Street attorney behind the poison pill, left, and Paul Roth, known as the 'dean of the hedge fund bar'

For most of his long career as a Wall Street attorney, Martin Lipton has been the man to call when companies find themselves under attack. He is a master tactician, famed for his ability to outfox the wiliest corporate raider or hostile bidder.

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Now in the sixth decade of his career, the takeover defence attorney is fighting as hard as ever. Yet despite his efforts, today's activist hedge fund managers are having great success in forcing their demands on reluctant companies.

The battles do not always go the hedge funds' way, as Dan Loeb has found at Sony and Carl Icahn has learnt at Apple and eBay. But look deeper, to the battles behind the battles, and it is clear that Mr Lipton and his supporters are on the back foot.

The intellectual winds have shifted after a decade bookended by the Enron fraud and the financial crisis and characterised by a drip of revelations on boardroom pay and perks. Institutional investors have been persuaded that company management has no monopoly on wisdom and that boards meant to oversee them might themselves be in need of oversight. "I'm in a minority, yes, but I wouldn't say that I was beleaguered," Mr Lipton says with a note of defiance.

More hedge funds today are styling themselves as activists and they are notching up significant victories. Their demands can vary widely, from the sale of a company to share buybacks to an operational shake-up. They may apply their pressure in private, as Jeff Ubben's ValueAct did to ease out Steve Ballmer as chief executive at Microsoft. Or they may do so in public, as in Nelson Peltz's campaign to make PepsiCo split off its snacks business. But they have in common a belief in their analysis and a determination to force change, even if it means storming their way on to corporate boards.

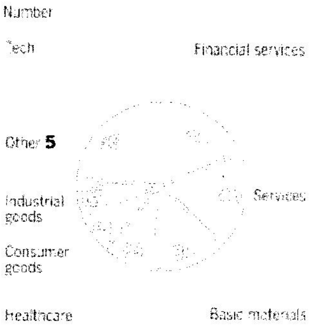
Success has attracted more money to the sector. Assets sit at a record $74.2bn, according to eVestment – and with Bill Ackman's Pershing Square teaming up with a hostile bidder for Botox maker Allergan this week, the activists' ambitions are growing.

The legal, regulatory and intellectual skirmishes taking place behind the scenes are setting the new rules which are shifting the odds in favour of the activists and away from the corporations.

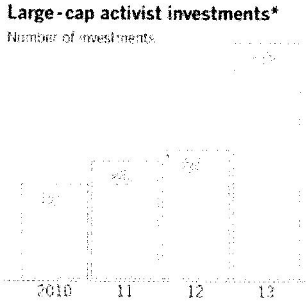
There are a half dozen or more of these fights raging. At issue are the acceptable use of poison pills, changes to corporate voting rules and the arcana of company bylaws, the role and power of proxy advisers and what hedge funds must disclose about their stakebuilding – and when.

"I'm still prepared to do the best I can to make sure that the playing field is level," Mr Lipton says. "We're not asking for protection; we're asking for a level playing field."

US public companies with activist investors, 2013



Large-cap activist investments*



* Companies valued at $10bn or more
Source: Activist Insight

In this debate, the playing field that is level to one man is uneven to another. "The first wave of attacks on activism focused on convincing shareholders that active shareholder engagement was somehow bad for them," says Barry Rosenstein of Jana Partners, which has taken on managements at Safeway, McGraw Hill and Agrium, among others. "Having failed at that, defenders of underperforming boards have launched a second wave focused on rule changes and technical defences. In the long run I doubt this will be any more successful."

These campaigns are sometimes fought with the fervour of a crusade. On one side are those, like Mr Lipton, who believe activists are exacerbating the markets' tendency to focus on the short term.

"Virtually every activist attack involves reduction in assets, reduction in invested capital, reduction in R&D, reduction in future capex and, most significant for the economy, reduction in employment," says Mr Lipton. "Is it good, appropriate national policy to permit Carl Icahn to scream at one company after another to try and get them to do something that will create profits for Carl Icahn?"

On the other side, activists' supporters say a company's owners need to be engaged for capitalism to work efficiently. The activists add that they have longer-term horizons than traditional fund managers who are obsessed with quarterly performance.

What Mr Lipton is to corporate defence work, Paul Roth is to the activists. Known as the "dean of the hedge fund bar", Mr Roth says activists tend to show up for a reason – and with a plan.

"Companies that are doing poorly are the ones that tend to get targeted," says Mr Roth. "A well thought out business plan for a company that has become somewhat entrenched in its thinking can result in all shareholders over time becoming substantially enriched."

Both sides profess to want a dialogue of ideas. But how sensitive directors are to shareholder opinion can depend on how easy it is for shareholders to vote them out if the board stands in their way. For this reason, activists and the largest institutional shareholders have joined forces to fight for better tools to unseat directors.

In this, the Securities and Exchange Commission tried but failed to help. It proposed in 2010 that dissident shareholders be allowed to place their own nominees on the ballot for board elections. But the US Chamber of Commerce and the Business Roundtable mounted a successful legal challenge. Fights for proxy access are instead sporadic, company by company.

Calpers, the California state pension fund, has also been putting resolutions to annual meetings demanding boards institute majority voting for elections so that unopposed directors must win at least half the vote to secure their place. While 84 per cent of S&P 500 companies now have majority voting, the number is well below half among smaller companies.

"Suffrage is being fought for in the land of the free and the home of the brave," says Anne Simpson, head of corporate governance at Calpers.

There is even tussling over how exactly the rules get changed. Boards can usually change corporate bylaws unilaterally but if shareholders want to alter them they require a supermajority, which is difficult to achieve.

Schulte Roth Zabel, Mr Roth's firm, sued directors of Bob Evans Farms, the restaurant chain, in January on behalf of activist Sandell Asset Management after the Bob Evans board overturned bylaw changes that had just been approved by shareholders. That case settled when the company reversed course. Lawyers are now looking for another opportunity to test the issue in court.

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It is not just the US judicial system that can arbitrate these skirmishes. When Wachtell Lipton, Mr Lipton's firm, was hunting last year for ways to repel activist advances, it hatched a plan that would make it harder for them to nominate alternative board candidates. The manner of its defeat revealed the power of another organisation that has its finger on the scales: Institutional Shareholder Services, a proxy adviser.

What happened? Activist hedge funds fighting for board representation have typically paid their candidates a fee to stand for election, given the time and potential bruises involved in a bitter proxy fight. But when two hedge funds, Jana and Elliott Management, proposed last year that they would also pay some of their nominees a bonus if the funds made money, institutional investors grew nervous about diverging incentives and disharmony in the boardroom. Sensing an opportunity, Wachtell Lipton proposed that companies ban director candidates from taking any payment at all, even a fee to stand. It drafted a bylaw provision that had been adopted by three dozen companies within a few weeks.

ISS is the largest of the proxy advisory services, which recommend how shareholders should vote in director elections, say-on-pay votes and the panoply of shareholder proposals that come up at annual meetings. Many small pension funds and institutional investors without the resources to assess every vote typically follow the recommendations of ISS or rival services such as Glass Lewis. Some recommendations are estimated to have the ability to influence up to one-third of the votes at certain companies.

ISS went into battle against the Wachtell Lipton plan. It recommended withholding votes for the re-election of directors of Provident Financial, one of the first companies to adopt it. Faced with this nuclear option, Provident backed down. Of the 33 companies that adopted the bylaw, two-thirds have since reversed course. Mr Lipton concedes the idea has died.

ISS has signalled it will use its power again. Directors of boards that ignore shareholder votes will find themselves with a negative recommendation when they are next up for election, it says. That could sharply alter the balance of power between boards and shareholders.

The proxy advisers' increased leverage, and greater determination to use it, has put them in the line of fire of corporations and their lobbyists, who have been trying to persuade the SEC to curb their power, or at least to complicate life for them by bringing them under new regulatory oversight.

"The question is whether ISS, which owns no stock, should have the power of a $4tn voter," a Wachtell Lipton partner told a roundtable convened by the SEC last December.

ISS says its policies on corporate governance issues reflect its regular surveys of institutional investors, hedge funds and companies. Critics say ISS is squarely in the activists' camp. The SEC is considering rules that would force the company to be more explicit about whether it is doing consulting work for the hedge funds, on whose proposals it is also making recommendations.

Chris Cernich, an ISS director, insists it makes such disclosures to clients already and has Chinese walls between its research and consulting divisions. "Hedge funds are pretty frustrated with us a lot of the time, too," he says. "We recommend against a lot of hedge funds, including hedge funds that buy research from us."

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Wachtell Lipton also appealed to the SEC to force activists to come clean about their stakebuilding earlier. Funds have to publicly reveal a stake of more than 5 per cent but they have 10 days to do so after passing that threshold. Together with buying during that grace period, Mr Ackman and other activists targeting JC Penney in 2010 suddenly emerged with 27 per cent of the retailer under their control.

The idea of speedier disclosure rules has been supported by Dan Gallagher, an SEC commissioner, and by Leo Strine, the chief justice of Delaware, where most large public companies are incorporated. Mr Lipton, however, does not sound hopeful that the SEC will act. "I think it's probably dead."

His pessimism over this and other battles behind the battles is the result of a December speech by Mary Jo White, the SEC chairman, in which she lauded activists. It reads like a personal rebuff to Mr Lipton's view of the world.

"It was not so long ago that the 'activist' moniker had a distinctly negative connotation," Ms White said. "It was a term equated with the generally frowned upon practice of taking an ownership position to influence a company for short-term gain. But that view of shareholder activists, which has its roots in the raiders of the 1980s takeover battles, is not necessarily the current view and it is certainly not the only view."

Mr Lipton will keep fighting, however, and perhaps his biggest battle of all is the one for public opinion. He is heartened that Larry Fink, BlackRock chief executive, urged companies to look past demands for short-term financial engineering and invest for the long term, even while BlackRock and other institutions make common cause with activists to boost shareholder democracy.

"I think we've made some progress with institutional investors," Mr Lipton says. "Not enough, but some. The other thing is to try to change the view of people who are essential to ultimate change in regulation. The battle is still there. Certainly I haven't lost it."

Sotheby's: Search for an antidote to the poison pill

Daniel Loeb: Designs on an 'old master'

Daniel Loeb's campaign to force himself on to the board at Sotheby's has been among the most deliciously rude of this year's crop of activist battles. Mr Loeb called the auction house "an old master painting in desperate need of renovation" and said executives "feasted on organic delicacies and imbibed vintage wines" at shareholders' expense. Sotheby's says Mr Loeb would be a "disruptive" director with "no relevant skills".

As the two sides try to win over a majority of shareholders, another struggle will affect not just Mr Loeb's Third Point fund but the balance of power between activist hedge funds and company managements.

An unwanted investor who is building a stake in a company can be stopped dead in his tracks if a board resorts to a poison pill, a potent defence tactic invented by Martin Lipton in 1982.

Third Point will ask a Delaware court next week to rule that Mr Lipton's creation has been taken too far and that Sotheby's is using it illegally to subvert shareholder democracy.

The pill has been upheld by numerous courts as a legitimate way to protect shareholders from a single investor taking effective control of a company without paying a takeover premium. It allows a company to issue unlimited amounts of new shares to existing investors so that no matter how many he buys a raider can never have more than a certain percentage of the shares outstanding.

Just as modern medicines can be engineered to home in ever more closely on the triggers of a disease, the poison pill has been refined to target activist investors ever more narrowly.

They have been imposed at increasingly low ownership stake thresholds in recent years. At Sotheby's passive shareholders are given an exemption and allowed to hold up to 20 per cent of the company while Mr Loeb and other activists are limited to 10 per cent.

The two-tier system is an "improper attempt by the directors of Sotheby's to entrench themselves in office", Mr Loeb argues.

The ultimate winner of the battle for Sotheby's board seats may have little resonance beyond the auction house's long-suffering shareholders.

The winner in court, however, will tilt the playing field for or against activism, with consequences for many battles to come.

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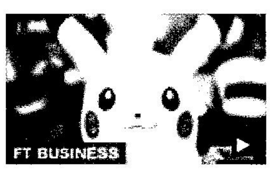

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BUSINESS

Are Activist Investors Helping or Undermining American Companies?

Journal examines 71 campaigns at big companies, finds runaway winners, a few duds

Activist investors, from left to right: Daniel Loeb, William Ackman and Carl Icahn.

By **DAVID BENOIT** and **VIPAL MONGA**
Oct. 5, 2015 1:55 p.m. ET

The rise of activist investing has sparked debate across markets, boardrooms and even during the presidential campaign: Are activist shareholders good or bad for business?

The Wall Street Journal examined that question with a comprehensive look at what happens to large U.S. companies after an activist arrives. The conclusion: Activism often improves a company's operational results—and nearly as often doesn't.

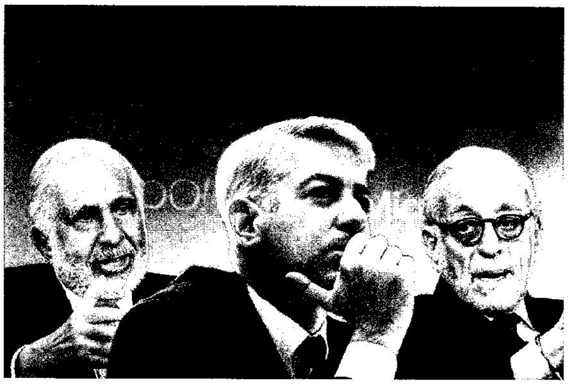
There has been a marked rise of activist investing over the past several years, with hedge-fund figures such as Nelson Peltz, William Ackman and Daniel Loeb buying up stakes in some of the nation's biggest companies, such as Procter & Gamble Co., Yahoo Inc. and Apple Inc., pushing for changes from buybacks to breakups.

In the latest moves, Mr. Peltz's Trian Fund Management LP on Monday announced one of activism's biggest investments ever, a $2.5 billion stake in General Electric Co. Also Monday, Ellen Kullman said she is stepping down as chairman and chief executive of DuPont Co., whose shares have struggled since the chemical giant in May blocked Trian's bid for a board seat.

The

Activist Investor Report Card

Click to see what happened at large U.S. companies that were targeted by activist investors.



Journal looked at 71 campaigns against companies with market capitalizations of more than $5 billion over a period dating back to 2009, the start of the surge of agitation.

The review studied changes at these companies in earnings, margins, corporate spending, employee efficiency and shareholder return versus peers.

The resulting data bolster the increasingly popular conclusion that the best corporate response to activism isn't for a board or chief executive to reactively shun an activist, or to completely acquiesce to any demands. Instead, companies may be better off analyzing each proposal, and the track record of the activist making it, some advisers say.

"The focus is changing to whether the idea is good or bad," says Avinash Mehrotra, co-head of Goldman Sachs Group Inc.'s activism defense and shareholder advisory group. One key factor in judging an idea's merits, he said, is the time frame an activist is demanding.

The review shows that shares of large companies confronted by activists are more likely to outperform stocks among their industry peers than they are to underperform. But the differential isn't great. Slightly more than half, or 38, of the situations in the Journal study led to better shareholder returns than industry peers for the period studied after the activist went public. In the end, the median campaign beat peers by just under 5 percentage points.

ACTIVIST INVESTOR REPORT CARD

- Nice Guys Finish First (http://www.wsj.com/articles/with-activist-investors-nice-guys-finish-first-1444068026)
- Icahn vs. Forest: a Lesson in Activism (http://www.wsj.com/articles/icahn-vs-forest-a-lesson-in-activism-1444070113)
- The Methodology Behind the Journal's Study (http://www.wsj.com/articles/the-methodology-for-activist-investor-report-card-1444067991)

At the same time, companies in the study slightly underperformed industry peers in terms of growth in earnings and slightly beat them on profit margins. As for capital spending as a percent of operating cash flow—seen as a measure of reinvestment—of the 48 companies in the study with good data for that measure, 25 raised spending or left it at the same level, while 23 lowered it.

While much has been written about the rise of activism, its long-term effect on companies remains little understood and hotly contested. Some contend activists are a much-needed check on corporate leaders, keeping them accountable for their decisions and spending. Others say that activists scare executives from wise decisions that need time to pay off. Still others say it is case by case, a view the Journal's data support.

Even those on opposing sides of the debate have recently suggested that the truth is somewhere in the middle.

Laurence Fink, CEO of money manager BlackRock Inc., has argued the economy is at risk because of the kinds of short-term moves often associated with activists, although he says he doesn't mean all activism is bad for companies.

Presidential candidate Hillary Clinton has pledged tax reforms targeting "hit-and-run" activists, though she also says some activists help hold managers accountable.

Activists themselves increasingly say not all campaigns benefit companies.

"We definitely do not believe that all activism today is a good or a catchall," veteran agitator Carl Icahn said in a recent interview. "There are bad activists, and we agree that it's bad. All they want to do is get in and rock the boat and make a quick trade."

In aggregate, the Journal data show, the best chance an activist has at driving outperformance at big companies is by getting a board seat, either for their own employees or a nominee they trust. Of the 38 situations in which activist-dogged companies outperformed industry peers, activists got a say on the board in 24. The outcome suggests that moving the needle at a big company—where leadership is already likely fielding advice from a host of bankers, lawyers and analysts—involves getting a voice in the boardroom.

Some activists regularly seek board representation, like Mr. Icahn, ValueAct Capital Management LP, Trian Fund Management LP and Relational Investors LLC. Their successes include Adobe Systems Inc. and Forest Laboratories Inc.

ValueAct used the board representation it had in all seven of its investments to outpace its rivals in the study. The San Francisco-based firm, whose founder and chief executive Jeff Ubben has been outspoken about his industry needing to avoid short-term profits at the risk of tarnishing themselves, had all seven of its investments in the survey beat peers, with a median 16.5 percentage points above peers. Mr. Ubben was recently nominated to the board of 21st Century Fox, which until mid-2013 was part of the same company as Wall Street Journal publisher News Corp.

Others clearly see the value of board intervention in big companies as well. In the 71 campaigns the Journal reviewed, 46 sought board representation and 40 got it.

Still, board influence doesn't ensure shares will rise: Sixteen companies that saw activists get on the board underperformed their peers. That included J.C. Penney Co., where Mr. Ackman's intervention contributed to an attempt to change corporate strategy that fell flat. J.C. Penney was the worst performer in the study compared with peers, and had the second-worst total-shareholder return. Only bankrupt energy company Walter Energy Inc. came in worse.

Far fewer activists working at the large-company level seem to bother with one of the most common requests for activists—stock buybacks, a generally shareholder friendly way to spend corporate cash. In the sample, activists sought buybacks in 25 of 71 situations.

The message: If you're going to target a big company, you've got to get more creative than just asking for a cash payout.

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Activists May Be Less Myopic Than Their Reputation Suggests

Andrew Ross Sorkin

DEALBOOK NOV. 4, 2015

Are activist investors short-term traders or in it for the long term? It is the question of the moment as nearly $200 billion has poured into the coffers of activists with names like Icahn, Ackman and Peltz, among others. Last year, as a group they put some 200 companies in their cross hairs and replaced 19 chief executives, according to the law firm Sidley Austin, putting pressure on virtually every board in the country to pay attention to this vocal class of shareholders.

If you listen to C.E.O.s and politicians on the stump these days, you would get the sense that most activists are dangerous quick-buck artists.

Carl C. Icahn, who has agitated for stock buybacks and dividends at companies including Apple, Motorola and Dell, has been described as a "financial parasite," a "greenmailer" and a "corporate raider."

"The bulk of activism just wants a quick hit. They want the stock to go up next week," Warren E. Buffett said last month at a Fortune magazine conference.

Hillary Rodham Clinton has derided what she describes as "quarterly capitalism," driven, in large part, by activists. "We need a new generation of committed, long-term investors to provide a counterweight to the hit-and-run activists," she said in a July speech at New York University.

It's a clean, simple and popular narrative. And it feeds directly into the debate about whether companies are focused too much on the daily fluctuations of their stock prices and not investing enough in their long-term futures.

Yet the data about how long activists like Mr. Icahn actually hold shares in companies, makes the narrative fuzzier — or at least more complicated. In many instances, activists may be holding shares longer than many institutional or retail investors.

Mr. Icahn's average holding period for an individual stock is not a month or two, — or even a year. It's more than three years, according to 13D Monitor, a data service that tracks activist investors. And it can be even longer, given that the calculation doesn't include several stocks in his portfolio that he's owned for 20 years, and in at least one case more than 30 years.

"The real money I've made over the years is holding companies for seven, eight or nine years," Mr. Icahn said on Tuesday at a New York Times DealBook conference. "You got to buy them when nobody wants them, that's the real secret."

Trian, Nelson Peltz's company, which has agitated for change at companies like Heinz and DuPont and recently made a $2.5 billion bet on General Electric, also holds its investments, on average, for about three years. When he takes board seats as a way to bring about change, the holding time is even longer, because selling stock as a board member is more difficult because of insider trading issues.

Holding a stock for three or four years doesn't make them Mr. Buffett, who owns stakes in companies for decades. But set against the average investor, activist investors may look like Rip Van Winkle.

According to data compiled by the global investment manager MFS after it sifted through New York Stock Exchange records, the average equity in 2014 was bought and sold in just 1.92 years. Mutual fund managers turn over their portfolios every 1.45 years, according to MFS. "Stocks are being held for record-short periods of time," MFS wrote in a report.

"Until the 1970s," the report said, "the investment landscape was largely dominated by wealthy individuals and families; this has since changed markedly, with professional investors now accounting for the largest share of investment activity, though it should be noted that these professionals manage significant mutual fund asset pools that are driven by retail investors."

Mutual fund managers may be focused on the short term because most consumers of investment products are no more oriented toward the longer term than activists. The average mutual fund is held for only 3.3 years, according to Dalbar's 2015 Quantitative Analysis of Investor Behavior.

None of this is meant to excuse activist shareholders' seemingly short-term financial engineering efforts, like buybacks, dividends, spinoffs and sales, which can quickly send shares spiking while potentially leaving the company more vulnerable later, especially when a company uses borrowed money to buy its own shares.

"The S.&P. 100 companies are paying out 108 percent of earnings through dividends and stock repurchases. That can't last," said Laurence D. Fink, chairman and chief executive of BlackRock, the asset manager. He blamed activists, in part, for why companies pursue such steps.

Mr. Icahn, of course, has another view: He suggests that he is pushing for measures to help flailing companies improve their long-term prospects.

"You have people that run companies that aren't bad people but shouldn't be running the companies. They're over their head or they have different agendas," Mr. Icahn said. "The reason I made so much money over the years is you hold these people accountable."

Whether value is being created or destroyed is still a subject of debate, but there has been little attention paid to the actual holding periods of activists.

William A. Ackman of Pershing Square Capital Management, the activist investor who took on Herbalife, owns shares for about a year and a half. His longest current investment, in the Howard Hughes Corporation, a real estate company, was bought in 2010, according to 13D Monitor.

Starboard Value, which has taken big stakes in Office Depot and Darden Restaurants, also holds its stakes, on average, for about a year and a half. ValueAct Capital, which recently took a stake in American Express, sticks around, on average, for two years, according to 13D Monitor.

For advocates of long-term investing, the goal perhaps should be as much about pressing activists to think long term as persuading the rest of us to do the same.

A version of this article appears in print on November 5, 2015, on page F1 of the New York edition with the headline: The Long and Short of It.

THE WALL STREET JOURNAL.

http://www.wsj.com/articles/activists-beware-huge-investors-debut-new-long-term-index-1453368603

MARKETS

Activists Beware: Huge Investors Debut New Long-Term Index

Investors will allocate $2 billion in the index to track shares of companies that focus on long-term goals

Mark Wiseman, chief executive of Canada Pension Plan Investment Board in a file photo from January 2015. Mr. Wiseman says CPPIB will invest slightly under $1 billion in the companies in the long-term index. *PHOTO: BLOOMBERG NEWS*

By **CHARLES FORELLE** and **DAVID BENOIT**
Updated Jan. 21, 2016 6:34 p.m. ET

A group of large global investors hopes a new stock index will prove that companies with good governance and focused on long-term goals will produce higher returns for shareholders.

Six global pension plans and sovereign-wealth funds debuted the S&P Long-Term Value Creation Global Index at the World Economic Forum in Davos, Switzerland, on Thursday, an index they said represents companies that can be role models for others.

Their move is the latest volley in a Wall Street debate that has spilled into the presidential election over whether corporations have become too obsessed with the short-term satisfaction of investors, particularly vocal activist shareholders, at the expense of future growth.

"We are trying to use the index to change corporate behavior," said Mark Wiseman, chief executive of the Canada Pension Plan Investment Board, the lead investor in the endeavor, in an interview at Davos.

CPPIB is a co-founder of Focusing Capital on the Long Term, a group of investing giants and executives looking to promote such thinking.

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Focusing Capital, whose other co-founders are consultant McKinsey & Co. and BlackRock Inc., the world's biggest money manager, offers something of a counter to the growing influence of activist investors, which buy stakes in companies and then press for changes they think can boost share prices. A Wall Street Journal study last year found that companies typically increase their buybacks and dividends and cut capital expenditures after an activist arrives.

The index comprises 246 companies, and initially the investors will commit $2 billion. It marks a concrete step for Focusing Capital to put money behind its ideas. The group hosted a gathering last year that included corporate executives and Treasury Secretary Jacob Lew, and it has published several articles urging companies to think long term and providing suggestions on how companies can overcome short-term distractions.

BlackRock CEO Laurence Fink is among the most vocal proponents of this mind-set, writing letters to the leaders of S&P 500 companies reminding them that, through vast index-tracking funds, the money manager will be invested "forever." He has criticized maneuvers designed solely to boost quarterly results and temporarily bump up stock prices.

The issue has spilled into the presidential campaign, with activist investors taking the brunt of the criticism. Hillary Clinton has proposed tax rules that would dent the profits of what she called "hit and run" activists by sharply increasing the capital-gains rate on short-term investments.

A debate, meanwhile, has raged among academics, lawyers and bankers over whether the stereotypical activist playbook produces desirable results.

A major point of contention is how companies should spend their cash. Some say that increased spending on research and development, capital improvements and hiring produce better long-term results, while others argue that returning cash to shareholders allows for greater investment elsewhere in the economy.

Activists, for their part, are a diverse lot that take different approaches in dealing with companies they target. Some stay invested in their targets for several years or push for corporate-governance changes designed to make companies more accountable to shareholders. And many big investors, including CPPIB and BlackRock, sometimes side with activists.

Focusing Capital said it isn't antiactivist. Indeed, the index chooses companies based on criteria many activist investors also would use in evaluating targets.

The new index will be based, in part, on a company's Economic Dimension Score, a grade calculated by a unit of asset manager Robeco that looks to quantify corporate governance, board independence and management pay incentives. The index will also look at financial metrics such as leverage and return on equity, a measure of profitability.

Managed by S&P Dow Jones Indices, the index's initial roster is led by Amorepacific Corp., a South Korean cosmetics company; tobacco company Reynolds American Inc. and health insurer Cigna Corp.

CPPIB, which manages some $188.23 billion, plans to invest just under $1 billion in the companies in the index, Mr. Wiseman said. The five other institutions participating in the index's launch are Singapore fund GIC, Danish pension plan ATP Group, Dutch pension plan PGGM, the New Zealand Superannuation Fund and the Ontario Teachers' Pension Plan.

Mr. Wiseman said he hopes retail products will be developed so individual investors can track the index.

The index isn't off to the best start this year, down 9.1%. That is slightly worse than the total return of the S&P 500, which is down 9%. An index of activist-targeted stocks managed by S&P is down by 19%.

Over one-, three- and five-year periods, the Long-Term index also beats activists and trails the S&P 500. But the activist index wins out over the 10-year period.

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