SHAREHOLDER ACTIVISM MANUAL

PREPARING FOR AND RESPONDING TO SHAREHOLDER ACTIVISM

NATIONAL ASSOCIATION OF Manufacturers

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Introduction

This Shareholder Activism Manual is designed to assist public companies and their boards of directors, policymakers and other interested parties in better understanding the many facets of shareholder activism. "Shareholder activism" is a broad term used to describe various shareholder efforts to influence corporate actions and corporate governance through a wide range of methods. The goals of these efforts are as diverse as the parties that engage in activist campaigns, and may include a more rapid return of capital to investors, a change in composition of management or the board of directors, a fundamental restructuring of the business, or change in corporate behavior on a particular social issue.

Though shareholder activism has existed on the margins for decades, in recent years it has become an increasingly common component of corporate governance at American public companies. Activists are growing louder and more assertive. Once regarded as a pursuit outside the boundaries of mainstream investors, some traditional institutional investors now no longer view activism as off-limits and have grown supportive of some activist strategies. Many of today's activist investors previously worked at the country's top investment banking firms and now call on those same firms for strategic advice. Additionally, many activists operate highly sophisticated, well-organized enterprises.

Activists generally fall into one of two broad categories: the issue-focused activist and the investment-focused activist. Even within these categories, activists pursue a variety of objectives.[1]

Issue-focused activists typically avail themselves of the shareholder proposal process permitted under rules of the Securities and Exchange Commission ("SEC") to pursue governance and policy reforms. On one end of a wide spectrum are "retail" activists, who are often individual shareholders with nominal investments in target companies. Further along the spectrum, various social and public policy investors make investments and submit shareholder proposals as part of a broader strategy of seeking to influence corporate behavior. Finally, larger activist investors—usually state and municipal pension funds or pension plans associated with organized labor—use the shareholder proposal process to advance political and labor-related objectives.

Investment-focused activists come mostly from the ranks of the hedge fund industry[2], though a handful of wealthy individual investors are also players in the space. While this Manual includes a brief discussion of the issue-focused activist, because the stakes are so high in an investment-focused activist campaign, the primary focus of this Manual is the investment-focused activist. Investment-focused activists usually purchase a significant but far less than controlling percentage of company stock, and then use the overt or implied threat of a proxy contest[3] to press for change that the activist believes will increase the stock price or otherwise return value in the relative near term. An investment-focused activist campaign typically imposes significant investor and public pressure on the board and management to justify a change in strategic direction, as well as company performance and leadership. These developments come at a time when traditional corporate defense mechanisms, such as the staggered board of directors[4] and the poison pill[5], are employed with less frequency than in years past.

Finally, this Manual contains a general discussion of strategies and tactics for engaging shareholder activists. In today's environment, no company is "too big" to be a target, and even companies outperforming their peers can elicit activist interest. In fact, several high-performing Fortune 100 companies have recently found themselves in activists' crosshairs. Additionally, an activist's share accumulations can be difficult to monitor given, among other things, the use of equity derivatives[6] and other cutting-edge trading strategies.[7]

More and more companies are experiencing an increase in shareholder activism. In fact, the March 2015 NAM/*Industry Week* survey of manufacturers showed that a majority of public company respondents have seen an increase in shareholder activism over the past two years. According to a 2015 Credit Suisse report, there were 514 investment-focused activist campaigns of one kind or another in 2014, the highest since the financial crisis, and a 20 percent increase from 2013.[8]

[1] For this reason, some commentators may use other terminology to describe activists. By way of example, some may instead refer to investment-focused activists as "value oriented" or "economic" activists. For ease of use, we use the "issue-focused" and "investor-focused" descriptions throughout this Manual.

[2] "Hedge fund" is a term used to describe a broad category of private investment partnerships that seek to out-perform the stock market by employing proprietary investment strategies for the capital they manage on behalf of investors. Hedge fund managers employ a wide variety of techniques to make an investment decision. Hedge funds often seek to capitalize on unique research, investment theories and market analysis that other money managers have overlooked or do not have the resources to conduct on their own. Most hedge funds seek to raise investment capital only from sophisticated institutional investors such as pension plans, charitable endowments, foundations and "family offices" that manage funds on behalf of wealthy individuals and their families. Although a handful of shareholder activists use their own personal fortunes, as opposed to funds supplied by third-party investors, for the sake of brevity this Manual will include such persons in the category of "hedge funds" as the two groups otherwise employ similar tactics and seek similar outcomes.

[3] A "proxy contest" is shorthand for a contested director election in which the company and an insurgent group each nominates its own candidates for the board of directors, and each group circulates its own proxy card to shareholders for voting for those candidates at the meeting.

[4] Under a "staggered" or "classified" board of directors, directors serve multi-year terms and are only up for election every two or three years, depending on the number of director classes. Unlike a declassified board, in which directors serve one-year terms and must be re-elected annually, a staggered board makes it impossible for an insurgent to replace the entire board in a single election.

[5] A "poison pill," also known as a shareholder rights plan, is a device that makes it prohibitively expensive to seek a change in control of a company because additional shares of stock are distributed to all other shareholders as soon as a potential acquirer purchases a set number of shares without the target company's board's consent.

[6] A "derivative" is a kind of financial instrument that derives its value from the performance of an underlying asset such as a particular security, financial index, commodity (like gold or silver) or interest rate. Some types of derivatives are traded in public markets just like stocks, and others are bespoke contracts entered into with a bank or other sophisticated counterparty. An equity derivative is a kind of derivative whose value is tied to the performance of one or more company stocks.

[7] These strategies may include purchasing call options on company stock, or simultaneously purchasing call options and selling put options on company stock (also known as a "collar" transaction). An option is a kind of derivative and is defined as the contractual right to buy or sell an asset (such as a share of stock) at a future date at a pre-determined price. A "put" option is the right to sell, and a "call" option is the right to buy.

[8] These numbers may not capture all investment-focused activity because it is likely they do not include all situations in which an activist privately approached a company and was dissuaded from going public with its demands.

Additionally, activist shareholder interventions have increased 88 percent between 2010 and 2013. In 2014, shareholder activists won a board seat in a record high of 73 percent of proxy fights, an increase from 63 percent in 2013. Furthermore, many activists have obtained board representation simply by threatening a proxy contest, as a number of companies have chosen to settle rather than bear the economic and reputational risks of a proxy fight.

Finally, this Manual contains a general discussion of strategies and tactics for engaging shareholder activists. Note that while this Manual summarizes current U.S. legal requirements and governance practices on shareholder activism, given the continuous evolution of law and practice in these areas, counsel should be consulted before taking any of the actions suggested in this Shareholder Activism Manual.

What is Driving Investment-Focused Activism?

The current environment presents a confluence of factors that drive investment-focused activism. First, growth and competition in the hedge fund industry has made activist investing an attractive strategy for fund managers. At the same time, activists may seek to exploit what they perceive as vulnerabilities within some public companies. To do so, the activists rely on a series of common techniques, and rely on other third parties to support their campaigns.

Why are hedge funds motivated to engage in shareholder activism?

More than 100 hedge funds are now engaged in investment-focused activism in one way or another. By one recent estimate, activist hedge funds have approximately $200 billion of assets under management and continue to attract investment from major traditional institutional investors. The additional capital and new partnerships between activists and institutional investors have made it possible for hedge fund activism to become more aggressive. During the recent financial crisis, many activist hedge funds were sidelined. But with increasing economic stability, hedge funds are expected to continue to engage in more activist behavior to increase returns.

There are several drivers of investment-focused activism. They include:

- *Economics of Fund Managers.* Most hedge funds employ some variation of the “Two and Twenty” compensation structure. Specifically, the fund manager receives a two percent management fee based on total assets under management, and a 20 percent “carried interest” tied to the profitability of the fund. The prospect of a windfall profit for the manager derived from a successful activist campaign incentivizes risk-taking.

- *Increased Competition for Investors.* Competition is fierce among hedge funds to attract and retain fund investors. At the same time, the federal securities laws have historically limited the ability of fund managers to advertise on behalf of their funds. Many fund managers nonetheless seek notoriety as a means of sourcing investors, and being associated with a campaign against a prominent public company is one more way to get noticed.

- *Driving Returns.* As part of the competition for fund investors, fund managers try to distinguish themselves by engaging in proprietary portfolio allocation strategies or pursuing novel investment theories[9] in an effort to outperform their peers. Several fund managers have sought to carve out a niche for themselves by event-driven (rather than arbitrage) strategies[10]—such as shareholder activism—to drive superior returns.

- *Deployment of Funds.* Many hedge funds raise capital from investors with the express purpose of using those funds to pursue above-market returns employing an activist strategy involving public company securities. Such hedge funds must eventually deploy those funds somehow, and there are only so many public companies from which to choose.

- *Short Slate.* The ability to propose a “short slate” (i.e., a minority) of directors has developed as a powerful bargaining chip for activist investors.

- *Role of Proxy Advisory Firms.* Though frequently criticized, proxy advisory firms remain influential and are frequent supporters of hedge fund activists.

- *Changing Attitudes.* Many conventional institutional investors are increasingly supportive of activist strategies and campaigns.

[9] Hedge funds deploy a wide variety of investment strategies. Each strategy is premised on one or more theories based on how the fund managers perceive the financial markets. For example, some funds pursue investment strategies based solely on a qualitative analysis of stock prices or expected movements in prices for commodities such as gold or silver. Others rely on quantitative models that use computers to execute trades in rapid fashion to exploit subtle movements in market prices. There are numerous other strategies as well. Some funds deploy a single strategy, whereas others deploy a hybrid approach. And a manager whose portfolio includes multiple funds may operate a different strategy at each individual fund.

[10] An arbitrage strategy seeks to exploit small price differences in a particular asset derived from inefficiencies in the market for that asset. In contrast, an event-driven strategy seeks to exploit one-off occurrences or transactions, such as the announcement of a merger or a company’s entry into bankruptcy. Shareholder activism is a kind of event-driven strategy.

What are some of the factors that make a company a potential target of activists?

There are a number of factors that increase the risk to companies of investment-focused shareholder activism. Often, activists will focus on a combination of several factors, though any one of these could arouse activist attention.

- *General Economic Conditions.* Macro-economic trends can negatively impact a company's operating results, which in turn can impact its stock price. An investment-focused activist may perceive that a particular company's stock is trading at a price below its optimal value, making it an attractive investment. The activist is then motivated to pursue measures that will lead to an increase in share price so the activist can sell its shares at a profit.

- *Short-Term Performance Problems.* Similarly, micro-economic factors can also impact a company's performance. When a company underperforms for a prolonged period of time, an activist can more easily make the argument that management and the board are not providing appropriate oversight and strategic direction, and that a fresh perspective is therefore warranted.

- *Perceived Governance, Compliance or Ethics Issues.* A company that is perceived as having a set of corporate governance policies that could serve to insulate management or the board from shareholder scrutiny (such as a staggered board of directors or lack of majority voting in uncontested elections) could attract an activist's attention.[11] In this scenario, the activist may characterize corporate governance as deficient and rally support among other investors. Likewise, a company that is the subject of a significant regulatory investigation or is perceived as having substandard compliance procedures or internal controls may open the company up to enhanced activist scrutiny, again on the theory that managerial and board oversight is lax.

- *Scrutiny of Management.* In some cases, investment-focused activists attribute a company's alleged performance problems to the perceived shortcomings of the senior management team, particularly the CEO. Similarly, an activist may seize upon the compensation paid to the CEO or senior management team, again if there is an apparent disconnect between pay and performance. Thus, an activist campaign may focus on recruiting or replacing one or more members of senior management.

- *Scrutiny of Board Composition, Compensation or Tenure.* Long-serving boards of directors that experience little turnover during a prolonged period of perceived underperformance by the company may themselves become the focus of activist scrutiny. In this scenario, the activist may cast a negative light on the board and attempt to rally other investors in favor of new board members who could bring a different perspective than the incumbents.

- *Capital Structure.* In a situation where a company is holding a large sum of cash, an activist may see opportunities to make changes to capital structure and seek an increase in the return of capital to investors through dividends, stock buybacks, or sales of company assets.

What are some of the techniques that investment-focused activists may employ?

One of the key objectives of many activist hedge funds is short-term value maximization. Once a potential problem at a target public company is identified, an investment-focused activist will then employ one or more of the following techniques to maximize the value of their position in a company in the short-term:

- Lobby the company to distribute more cash to stockholders through buybacks, self-tenders or special dividends that are funded by cash balances, increased borrowing, asset sales or reduced capital expenditures. This kind of activism is sometimes referred to as "balance sheet" activism.

- Encourage the company to engage in strategic review, including portfolio changes or restructurings such as sales or spin-offs of the company's non-core lines of business.

- Seek operational changes at the company to improve business operations by cutting costs and changing product mix. This kind of activism is sometimes referred to as "income statement" activism. This technique is the hardest to accomplish for hedge funds because it requires discrete operational experience and returns may not be recognized immediately, if ever.

- Put the company "in play," which means beginning a process whereby the company is sold to a third party. This technique is accomplished through board pressure, public relations, soliciting potential buyer interest or offers to purchase the company.

- Block or modify the terms of significant transactions in which the company is engaged (e.g., a merger with, or acquisition of, another company). This kind of activism, described in more detail below, is sometimes referred to as "M&A" activism.

- Pursue governance changes, such as the dismantling of corporate defenses or the implementation of new governance procedures that are perceived as being friendlier to shareholders.

- Change the company's board or CEO through running a "short slate" (e.g., one-third of the board). Nominees may include principals from the hedge fund, but also will include "independent" nominees. This strategy is often not an "end" in itself; rather, it is used to advance the hedge fund's broader agenda.

[11] Under most state corporate laws, the default standard for electing a director is a simple plurality of votes cast, i.e., the person receiving the most votes—even if less than a majority—wins. Under this standard, in an uncontested election (i.e., the number of candidates matches the number of open seats), a director need only receive a single vote. Many public companies voluntarily have implemented procedures by which a majority of votes is required in an uncontested election.

What does "M&A" activism entail?

Another increasingly common strategy for hedge fund activists is to challenge a separately announced merger or acquisition transaction (M&A) involving the company, typically when the company has agreed to merge or otherwise be acquired. The activist's end game is to obtain a higher premium for the company stock at the completion of the transaction. To achieve this result, activists employ a range of techniques, including agitating for a sweetened offer, encouraging a third party to submit a topping bid, suing to block transactions on the grounds that the board has engaged in a fiduciary duty violation, taking other steps to discourage other investors from voting in favor of the deal, or pursuing the statutory appraisal remedy when available.

As noted above, investment-focused activists also may seek to commence a process to sell the company or spin-off significant subsidiaries in an effort to unlock value that the activist asserts is not reflected in the company's stock price. Though rare, if an activist is committed to pursuing a transaction and does not believe informal discussions with the target remain productive, it may consider sending a "bear hug" letter to the company, which would describe proposed terms of a transaction. Bear hug letters may be issued either privately or publicly and are designed to exert pressure on a company's board of directors to negotiate with the bidder or at least take a position, one way or the other, on a given proposal. An activist could also make an unsolicited take-over offer for the entire company by means of a tender offer.[12]

What is the role of proxy advisory firms?

Stemming from a series of Department of Labor and SEC pronouncements in the 1990s and early 2000s that encouraged (or required) various classes of institutional investors to vote their shares in public companies, the proxy advisory industry has evolved into a key player in the world of shareholder activism. Proxy advisors cull through the SEC disclosures, corporate governance policies and proxy statements of public companies, then make annual recommendations to the advisor's investor clients as to how a given company's shares should be voted at shareholder meetings. Though there are several niche players, the industry is dominated by two firms that collectively control a market share in excess of 95 percent by most estimates.[13] Institutional investors place varying degrees of weight on proxy advisor recommendations, but at some public companies, the two largest proxy advisory firms can influence anywhere from 20 percent to 40 percent of the shareholder vote. Notably, proxy advisory firms often support insurgent candidates to the board in proxy contests. Despite calls for reform, and recent SEC staff guidance on proxy voting and proxy advisory firms, it appears that the two dominant proxy advisors will continue to exert considerable influence on proxy voting at public companies for the foreseeable future.

How do mutual funds fit in?

Mutual funds have shown a historical reluctance to play an activist role, as they often have a very long-term investment horizon and prefer to avoid direct confrontations with their portfolio companies. Recent years, however, have seen a growing number of mutual fund managers that are willing to speak out on performance and governance issues at the public companies in which they invest. Some mutual funds are even adopting activist agendas and allying with activist hedge funds. Still others will support hedge funds and others waging activist campaigns on a case-by-case basis.

How does an Investment-Focused Activist Campaign Unfold?

Once an investment-focused activist decides to target a particular company, it will usually commence a process that involves some or all of the following steps, depending on the desired investment outcome. This graphic provides a concise summary of those activities, with more explanation following.

Passive ownership	Private lobbying of board/management	Publicly oppose Company's strategic plans; public, personal attacks on board & mgmt; organizate opposition (e.g., recruitment of other shareholders)	Nominate short-slate (approx. one-third or less) of directors for elections committed to fund's strategic initiatives Inspect books and records	Nominate majority slate of directors committed to fund's strategic initiatives Submit "bear hug" to put company in play	Hostile tender offer and/or support of third-party hostile transaction

[12] A tender offer is a public offer to shareholders inviting them to surrender or "tender" their shares in exchange for a cash purchase price. Because the tender offer is made directly to the company's shareholders, it does not require approval or consent of the target company board of directors.

[13] The two firms are ISS and Glass Lewis & Co.

What are the first steps in an investment-focused activist campaign?

Preliminary Planning. An investment-focused activist will form a plan of attack before formally approaching a target, which often includes assembling an internal deal team and a group of legal and financial advisors. Goals, including entrance and exit strategies, may be established and timing issues are often considered. The activist may also informally approach other investors to test the waters and gauge their potential level of support.

Acquiring Stock. The activist hedge fund's initial step is accumulating stock in the target company. Under SEC rules, beneficial owners[14] of more than five percent of a public company's stock must identify themselves by filing a publicly available SEC form known as a Schedule 13D (or under limited circumstances, a short-form Schedule 13G). The Schedule 13D filing must be made within ten days of crossing the five percent threshold, which permits time for additional purchases during these ten days. Many activists therefore continue to acquire more shares during the ten-day period. Because of this phenomenon, the SEC's "early warning" on Schedule 13D may not provide timely notice, and a target company may first learn of the stock accumulation through an activist's Hart-Scott-Rodino Act ("HSR") antitrust filing.

Antitrust Approval. Under HSR, if a shareholder seeks to make an open market purchase that would cause its total holdings to exceed the HSR filing threshold ($76.3 million for 2015, but subject to annual inflation adjustment) and is not eligible for any exceptions, it must file an HSR notice with the federal antitrust authorities, notify the target company in advance of such filing, and observe a required waiting period before completing the acquisition. Aware of this filing requirement, some activist investors structure their open market purchase to stay below the HSR triggers. Notably, HSR does not have any "group" concept, so unaffiliated acquirers are not required to aggregate their holdings for purposes of HSR reporting unless the activist has beneficial ownership in the shares held by such unaffiliated acquirers. Note that failure to observe the HSR filing requirement may subject the activist fund to a maximum civil penalty of $16,000 per day, but beyond this penalty there is no other sanction for failing to observe the HSR requirements.

Flying Under the Radar. Investment-focused activists often operate in ways that do not trigger real time SEC disclosure. For example, activists may

- use derivatives (as described below) to acquire a large stake all at once without prior notice;
- ensure that they continue to hold less than five percent of company stock to avoid triggering extensive disclosure on Schedule 13D of accumulations and plans regarding accumulations; and
- work in parallel with other activists, but without forming a group holding greater than five percent, which would trigger disclosure (sometimes known as "wolf pack" activity).

While most institutional money managers must also file quarterly reports on SEC Form 13F regarding publicly-traded stock in their portfolios, these reports are not due until 45 days after the end of the quarter and thus often are not helpful in providing real-time information about an activist's ownership position.

Use of Derivatives. Activist hedge funds may invest in derivative instruments such as cash-settled swaps to acquire the economic attributes of stock ownership while circumventing the "beneficial ownership" requirement that triggers the filing of Schedule 13D. A cash-settled swap is a type of derivative contract that allows the purchaser to obtain many of the economic benefits of investing in a particular stock over time without ever purchasing the actual stock itself. Because settlement of the swap at its maturity date is made in the payment of cash, rather than the delivery of physical securities, entering into this kind of derivative may not be deemed to create beneficial ownership of the reference company stock. Additionally, state-law merger moratorium statutes[15] and poison pill triggers tied to "beneficial ownership" may also be avoided through the use of derivative instruments.

When does the activist contact the company or the public?

Request to Meet with Management or Board. Once an ownership interest is established, activist hedge funds will often (but not always) bring their demands directly to the target company and seek a private meeting with management or members of the board. At the meeting, the activist will preview its proposed strategy for the company and seek voluntary cooperation from the company to avoid the need to take its demands public. The activist may also request that one or more of its representatives be placed on the target board of directors.

Engage in Public Attacks. Depending on a target company's response to an activist hedge fund's initial approach, the activist may see the need to reveal its plans to the public in an effort to build support from other investors. In some cases, the activist bypasses the private meeting request altogether. Next steps in this process for the activist may include:

[14] Because most shareholders no longer obtain physical stock certificates but instead hold their shares in "street name" through an account at a bank or broker, SEC rules for completing Schedule 13D focus not so much on who the "record holder" of the shares is (i.e., the bank, broker or other nominee), but instead on who is the ultimate brokerage customer that possesses final control over voting or selling the shares. Under this "look-through" standard, that ultimate customer is called the "beneficial owner" of the shares.

[15] Many states have adopted laws that limit a shareholder's ability to acquire or vote shares in excess of a set amount (e.g., 15 percent of total shares outstanding) without obtaining prior consent of the board of directors.

- publicly releasing letters to management or the board (including "Schedule 13D Letters" filed with the SEC),
- unveiling a detailed proposal regarding the company,
- engaging a financial advisor to bolster credibility,
- meeting with the media to discuss the company;
- issuing a detailed "white paper" analyzing the company and providing a strategy for restructuring the business,
- meeting with other institutional investors to lobby for the implementation of its plan, and
- making a "books and records" request under state corporation statutes to examine board materials and other information.

The "Wolf Pack" Phenomenon. If an activist makes its interest in a company public, such disclosure serves as notice that the company may be in play, resulting in an additional accumulation of the company's stock by unaffiliated but pro-transaction shareholders. These unaffiliated shareholders are sometimes referred to collectively as a "wolf pack." Such share accumulation may magnify the influence of the original investment-focused activist. And, if the activist ultimately determines to halt its activities and liquidate its position in a company stock, an increase in value of the stock based on the interest of others in the wolf pack can be used to recoup the costs of its efforts.

Will the activist request board representation?

Pursuing Board Seats. Obtaining board seats is a common ask of investment-focused activists. In situations in which a company does not offer a seat on the board of directors to an activist, an activist may seek to replace one or more company directors with its own nominees. Hedge funds generally have the resources to wage a sophisticated campaign, including circulating their own proxy statement, engaging in a public relations campaign and paying third parties to solicit proxies on their behalf. In rare circumstances, an activist may attempt to unseat an entire board of directors, but a tactic that is gaining in popularity among activists is to nominate a number of directors that is less than a majority (i.e., a "short slate" of directors) for election to a company's board. SEC rules allow the dissident to "round out" its slate of nominees by including in its proxy card nominees named in the company's proxy statement without obtaining their prior consent. The rounding out permits other stockholders to vote for the dissident's short slate without giving up their right to vote for all seats up for election.

In many proxy contests, the two dominant proxy advisors tend to support at least some dissident candidates, particularly where control is not at issue. Also, institutional investors are increasingly likely to support dissident nominees. Many proxy contests result in settlements in which some or all of the hedge fund's nominees join the board. As an aside, a possible (though less frequent) tactic for an activist is to run a campaign to vote against other proposals up for a shareholder vote, such as a competing transaction.

Do activists team up?

Teaming. From time to time, two or more investment-focused activists will deliberately join forces in pursuit of a single company. In 2014, however, a prominent activist hedge fund took the unusual step of teaming up with one public company in order to make a hostile bid to acquire a competing public company. The hedge fund began accumulating the target company's stock, and had amassed a 9.7 percent stake by the time of announcement. At first, the activist tried to orchestrate a nonbinding vote of target shareholders to pressure the target company to negotiate; however, the activist reportedly changed strategies because the target's institutional shareholders expressed concerns that if they voted in support of the nonbinding proposal, the target's poison pill may be triggered. The activist then sought to hold a special meeting to, among other things, remove a majority of the target's directors. The strategy eventually resulted in litigation between the target and the activist. Ultimately, the target pursued a competing transaction and found a "white knight" to acquire it at a higher price. The tactic of an activist teaming with a strategic investor caught many observers by surprise and has led to significant debate as to the viability of the technique in the future.

How Should Public Companies Engage Investment-Focused Activists?

In the past, many companies reflexively erected a series of defensive barriers at the first sign of activist interest, then refused to engage with the activist in any kind of discussion or negotiation. While these practices may still be appropriate under certain circumstances, many companies are finding that scorched-earth tactics quickly become counter-productive. Instead, they are finding benefit in engaging their institutional investors and, in some cases, activist investors in more frequent and more substantive conversations. With appropriate preparations, discussions with shareholder activists can even be fruitful. Of course, each activist campaign will necessitate a different set of responses and defensive measures, based in large part on what the activist is requesting.

How should management and the board position the Company?

Even without the threat of activism, management and the board should be engaged in a constant, deliberative process focused on operating the business for the benefit of all shareholders. To that end, boards and management should regularly assess the company's business plan and prospects, giving thought to areas for possible change or improvement. Some action items to consider include:

- *Optimize operations efficiency.* The most effective corporate strategy available to a company is credible value creation for investors combined with disciplined management of expenses. Such a strategy counters an activists' potential argument that the business is not being operated at maximum efficiency or that management is overlooking obvious opportunities to expand the business, pursue an acquisition or reduce costs. This strategy will also provide the best defense to hostile offers, which are often based on the value-creation potential associated with a business combination.

- *Return capital to investors.* Companies perceived as hording cash can quickly become the target of an activist. If there is no need to use accumulated earnings to pay down debt, fund research and development, increase marketing spend or for some other productive use, a company may wish to consider returning some cash to shareholders. Continually increasing dividends could have the effect of supporting the share price as investors assess a greater return by holding on to their shares rather than by selling them. Engaging in share buybacks can also be viewed as an efficient use of cash.

- *Active communications strategy.* Clearly articulate the company's value creation strategy and make sure the company's constituents know and understand the strategy. The ability of the board and management to address shareholder activism pressures depends largely on communicating effectively regarding long-term strategy, risk oversight, management succession and company performance. In addition to typical shareholder communications channels, companies should also develop relationships with reporters at key financial and industry publications.

Likewise, the board and management should also assess potential company vulnerabilities that relate to how activists may view the company's performance, strategy and governance. Activist hedge funds frequently try to drive a wedge between the company and its investors by suggesting that the business is underperforming because management has failed to pursue new opportunities for growth or cost-cutting. To counter that argument, the board and management should:

- Identify areas that could make the company the target of shareholder activism;

- Consider the company's positions on those topics and prepare responses;

- Consider the company's defense profile;

- Monitor governance and activist developments to stay abreast of "hot button" issues;

- Assure that procedures are in place that detail how members of management and directors should respond if they receive a call from an activist;

- Invest in building positive relationships with the company's large long-term shareholders; and

- Identify the team of advisors (including legal counsel, financial advisors, investor relations personnel, public relations experts and proxy solicitors) that the company would retain in an activist situation and discuss these issues with them.

Although it is possible for a company to conduct this self-assessment entirely using internal resources, the process is usually conducted with the assistance of outside legal and financial advisors that are experienced in defending against activist campaigns. Through a series of discussions with senior management and the board, together with their own analysis of the company's operations and governance, the outside advisors can help management and the board identify where the company may have potential weaknesses that could attract an activist's attention. Some boards have found it productive to retain legal and financial advisors that do not normally represent the company to fill this role.

How does the company maintain clear lines of communication with investors?

Years ago, many public companies had little routine interaction with shareholders other than at the annual shareholder meeting or periodic investor conferences. Today, public companies of all sizes have implemented shareholder communications plans that feature routine outreach to key shareholder constituencies. A regular plan of shareholder engagement can also be a central part of discouraging shareholder activism.

Boards and management should be attuned to how shareholders and financial analysts perceive the company. Long before a potential activist comes calling, the board and management should be engaged in regular dialogue with major shareholders to better understand their interests and concerns. Many institutional investors have bifurcated the portfolio management and proxy voting functions, so the outreach process may entail meeting not just with portfolio managers, but also appropriate personnel responsible for proxy voting. Even within the same organization, these two groups may have substantially different perceptions of a given portfolio company.

While boards should generally be aware of the views of a broad cross-section of their shareholder base, this process will also give greater insight into which shareholders are supportive of (or hostile to) management. The company can then devote additional resources to cultivating relationships so that the board will be in a position to identify friendly investors in the event an activist approaches.

Depending on the investor and its preferences, it is not just the company's investor relations officer who makes these visits, but also other senior executives and, in some cases, one or more independent directors. Historically, directors have usually not been involved in meetings with shareholders. But in today's rapidly changing world, a greater level of director involvement may be important. Independent directors may, for example, seek input from larger shareholders to preemptively manage situations and understand shareholder views on important matters such as long-term strategy, performance of the CEO and management team, and executive compensation. In this way, independent director meetings with a company's largest shareholders becomes a routine part of a board's approach to outreach with its shareholders. Developing this kind of rapport will also help the board avoid creating the misimpression that they only value shareholder input in exceptional circumstances or in times of crisis.

The investor relations officer plays an important role in understanding the mood of shareholders generally as well as the priorities of key institutional investors. He or she is also critical in assessing exposure to an activist attack and in a proxy solicitation. In addition to its traditional responsibilities, the investor relations function should assume responsibility for monitoring:

- the company's peer group, sell-side analysts, proxy advisors, activist institutions, internet commentary and media reports for opinions or facts that will attract the attention of activists;
- the changes in hedge fund and institutional shareholder holdings on a regular basis, and understanding relationships among holders, paying close attention to activist funds that commonly act together or with another institutional investor;
- proxy advisory firms' corporate governance policies, as activists may try to "piggy-back" on these issues to bolster the argument for management or business changes;
- third-party governance ratings and reports for inaccuracies and flawed characterizations; and
- conference call participants, one-on-one requests and transcript downloads.

How should a company prepare for investment-focused activists?

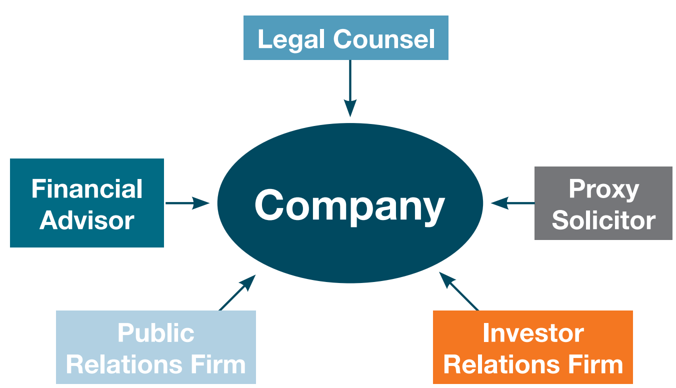
A company's goals for its response to activists should be:

1. Articulate a clear, long-term value proposition;
2. Communicate its ability to execute the company's long-term strategic plan; and
3. Ensure that shareholders have all material information relative to activist's agenda and the company's strategic plan.

The board can best protect the company by ensuring that the directors are educated on possible threats and the company is prepared to respond quickly. Legal tactics may be helpful, but most activist hedge fund campaigns are won or lost at the ballot box or in a "court of public opinion," and far less frequently in an actual courtroom.

A company should assemble a standing team of legal advisors, financial advisors, investor relations personnel, public relations experts and proxy solicitors who are prepared to go into action on a moment's notice. The company should be monitoring the investor environment continuously, including the company's stock trading volume, its shareholder base and social media, and should provide periodic updates to the board. The team of advisors should also have periodic meetings, including fire drills to maintain a state of preparedness. Many companies benefit from keeping abreast of the hedge funds that have made activist approaches generally, with a particular focus on those that have approached other companies in the same industry, as well as the tactics each fund has used.

Additionally, it is important to regularly review takeover defenses and bylaws in place to ensure they remain state-of-the-art. In particular, companies should look at advance notice bylaws and flexibility relating to conduct of shareholder meetings (e.g., chairman's ability to recess and adjourn). In addition, boards may want to consider an exclusive forum bylaw to manage the venue in which shareholders may pursue litigation against the company. Boards could also consider having a "shelf-ready" shareholder rights plan to adopt in response to rapid stock accumulations, which plan includes triggers for derivatives and other synthetic ownership techniques.[16]



[16] An "on the shelf" rights plan (or poison pill) includes a draft of all key documents so that the rights plan may be implemented quickly. Draft documents include (i) a rights plan, (ii) board resolutions, (iii) an SEC Form 8-A, (iv) an SEC Form 8-K, (v) a letter to shareholders, (vi) a stock exchange listing application and notice, (vii) a press release, (viii) a board presentation, and (ix) a time-and-responsibility checklist.

In short, a company should be prepared for shareholder activism prior to its occurrence. The best defense is done on a "clear day," and both courts and investors can be skeptical of defensive measures that are adopted during a crisis when it is perceived that a board is acting under duress.

How does a company respond to investment-focused activists?

A company should engage an investment-focused activist shareholders carefully. It is important for a company to understand the activist's agenda in order to engage the merits with the activist and, as necessary, the investor community.

Meeting with the Activist

The activist may contact someone at the company directly, or the activist may send the company a letter requesting a private meeting, frequently with an overview of its proposed strategy for the company. Some companies try to keep activists at a distance for as long as possible. While every situation is different, this approach is often an imprudent one to take as it will shape an activist's view of the company in a very negative way. This approach may also give the activist the misimpression that management is entrenched and not receptive to shareholder input.

If an activist submits a proposal, the company should promptly (and privately) acknowledge receipt of the proposal to the activist. Thereafter, the board, management and advisors should convene to discuss the proposal. The board can then respond privately with its decision whether to engage in any discussions. When an activist approaches a company to request a meeting, it is usually advantageous to respond quickly. If a decision is made to meet with the activist, preparation for that meeting is key, and the first impression a company makes with the activist can be a lasting one. Careful consideration should be given as to who should attend the meeting.[17]

If a decision is made to meet with the activist, the company's representatives should largely be in "listen only" mode at the meeting. This is an opportunity to observe the activist in person and gain a better understanding of the activist's concerns. Of course, company representatives should always consider Regulation FD concerns about selective disclosure when meeting one-on-one with any investor.[18] Company representatives should not seek to engage in a point-counterpoint style of debate, but instead they should listen carefully and promise to schedule a follow-up meeting to respond.

Activists don't always present wrong-headed ideas, and there may be an opportunity to collaborate with the activist to implement one or more of its ideas in a mutually beneficial way. On the other hand, if the company after careful analysis determines that an activist's strategy is based on misinformation or is otherwise impractical, a follow-up meeting may be the appropriate setting to educate the activist on where the company believes the activist has gone wrong. The key here is being able to credibly convey the message that the board has analyzed the activist's proposal and why that proposal is not right for the company. The dialogue should always be respectful and professional, and the company should take care not to make statements or reveal information that an activist could later use against the company if it were to escalate its engagement. But many activists will reassess their positions after meeting with the company, and will often move on to targeting a different company where their efforts may bear more fruit.

What the Board Can Expect if an Activist Becomes Hostile

Despite a company's best efforts to engage an activist in private in a constructive manner, part of the activist strategy often includes taking the matter public and launching a campaign to gain support for its position among other investors, proxy advisors and other stakeholders. Activists may choose to engage the public through multiple channels, and boards and management should expect both close scrutiny and heavy criticism during this process. An activist's attacks may seem personal and at this stage may contain half-truths or other potentially misleading information. This is when all the company's advance planning becomes valuable. Companies are best served by keeping to the high road, avoiding personal attacks, and staying on message as they counter the activist's public attacks.

The Board's Role and Fiduciary Duties

The board's fiduciary duties remain the same during an activist campaign, although the board's decisions and decision-making processes may face a heightened risk of scrutiny in litigation. Therefore, as with all board activity, it is prudent to maintain records that show an informed decision-making process.

When dealing with shareholder activism, the board should be guided by its fiduciary duties and the long-term best interests of the company. Under the corporate laws of most states, a director owes fiduciary duties of care (to be informed of all material facts reasonably available when making a decision) and loyalty (to avoid self-dealing and act in good faith). Directors are generally entitled to rely on information, opinions, reports, and statements of board committees, officers, employees and outside advisors, including legal counsel, financial advisors and public accountants. Directors and officers should also observe their duty of confidentiality.

During an activist campaign, it is critical for the company to speak in a single voice. Companies should avoid presenting a mixed message to the public or having multiple representatives speak on the company's behalf. Activists will seek to exploit any evidence of lack of coordination or internal disagreement at a target company.

[17] Legal counsel (most typically the company's chief legal officer) often—but not always—attends the meeting. Whether to include counsel should be considered as part of the overall response strategy.

[18] SEC Regulation FD (for "fair disclosure") generally prohibits public companies and personnel acting on their behalf from selectively disclosing material, nonpublic information to certain groups, such as brokers, investment advisers, analysts and shareholders who are likely to trade on information, without obtaining assurances of confidentiality or otherwise concurrently making widespread public disclosure.

Accordingly, the CEO is typically the sole spokesperson for the company, and other corporate representatives (including members of the board) should observe a strict "no comment" rule with respect to any press or other third-party inquiries. From time to time, however, the CEO or management may be the subject of an activist's attacks, in which case a non-executive chairman or lead independent director may assume a greater role as the company's representative. In any event, directors and officers should be sensitive to note-taking, emails and other written correspondence with one another as all such materials will likely be discoverable in litigation.

Other Tactical Options for the Company

Negotiated settlements between the company and the activist are common. Sometimes activists move on if they perceive that their dialogue with the company has been productive and that the company has engaged them in an earnest fashion. Many threatened proxy contests never actually go to a vote.

As with any negotiation, companies should carefully weigh the costs and benefits of compromising with an activist. Companies are cautioned to avoid efforts at simple appeasement. Rather than leading to full and final resolution, appeasement one year frequently invites further activism (often by different players) in subsequent years.

Of course, there are times when it is in the company's best interests to avoid outright confrontation with the activist. In making the decision to compromise, board of directors should be guided by their fiduciary duties as they consider the totality of the circumstances. Seeking input from legal and financial advisors will be crucial. Although there is no single formula, many activists are satisfied when a target company offers to add one or more activist nominees to the board or agrees to explore strategic alternatives with the activist.

In the absence of an amicable resolution, a company may also consider launching its own affirmative public relations campaign. Pursuing this course will necessarily involve close coordination between legal counsel and public relations advisors. The purpose of a public relations campaign is to create support among institutional investors, encourage involvement of retail shareholders and tell the company's story about the benefits of its long-term strategic plan.

Elements of the campaign may include:

- holding analyst and shareholder meetings, again with due care for the requirements of Regulation FD,
- providing interviews with the press and contributing to other media stories,
- preparing targeted letters to shareholders, and
- circulating proxy solicitation materials.

Finally, a number of legal defense mechanisms remain viable. Appropriate charter and bylaw provisions can still be effective in discouraging or repelling an activist campaign. State control share and anti-takeover statutes can also serve to impede hostile accumulations of stock. If a dissident gains board representation, board confidentiality policies may need refinement.[19] And, as a last resort, litigation against a hostile activist may be necessary.

Again, no two activist campaigns are identical, nor are the company responses. While the foregoing strategies are frequently useful, each company should tailor its own response to an investment-focused activist based on the unique facts and circumstances presented by its business model, shareholder base and future prospects.

What is Issue-Focused Activism?

For many public companies, the most frequent form of shareholder activism is the shareholder proposal for inclusion in the company's proxy statement under SEC Rule 14a-8. SEC rules permit such proposals on a wide variety of topics. As described below, a relatively small group of issue-focused actors dominates this process. These groups constantly reassess which companies to target, and for companies that do not regularly receive shareholder proposals, the first one can be unsettling. Though the goals of an issue-focused activist may not be a fundamental transformation of the business, as is often the case with investment-focused activism, engaging an issue-focused investor requires an equal level of preparation and focus.

What is at stake?

Issue-focused activists often advance idiosyncratic agendas that are unrelated to increasing long-term value for all shareholders. Unlike a boards of directors that is required to act in a company's best interests pursuant to well-established fiduciary duties, shareholders generally do not owe fiduciary duties to the company or other shareholders. Thus, issue-focused activists are usually free to pursue their goals without consideration of the overall impact on the company and without regard to the costs or burdens consequently borne by the company or other shareholders.

For many issue-focused investors, achieving some change in corporate behavior is the ultimate objective. The impact of the activist's agenda on the profitability of the business and consequences to other corporate constituencies such

[19] A recent Delaware case (Kalisman v. Friedman) gives broad access to hedge fund and other special interest representatives on a board of directors. A director's access to information "is essentially unfettered in nature" and includes all attorney-client communications with the board's counsel (subject to certain exceptions). The ruling suggested that a director could share information with the stockholder that appointed him or her. The court stated, "[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director."

as employees or customers are often of less importance to the activist. Issue-focused activists frequently do not limit their activities to a single company, but instead target a broad segment of public companies or even entire industries. The players described below regularly coordinate their efforts and support one in another when it comes time to vote.

Many social or political shareholder proposals are part of a broader campaign to discourage corporations and their employees from participating in the public debate on issues of importance to American business. Companies that seek to appease issue-focused activists, whether through making voluntary disclosures or adopting other changes in corporate practices, often discover that activists are emboldened to seek additional concessions in future years. These companies then find themselves in a vicious cycle in which activists continue to demand more and more year after year.

Who are the key players in issue-focused activism?

"Retail" Investors

The primary strategy of "retail" activism is through the use of shareholder proposals.[20] Under SEC Rule 14a-8, any shareholder holding at least $2,000 of company stock for one year can submit a proposal for inclusion in the company's proxy statement for action at the annual shareholder meeting, subject to a narrow set of eligibility criteria. Retail activists generally lack the time and resources necessary to pursue other strategies or wage public relations campaigns.

Retail activism is dominated by several well-known personalities. According to Proxy Monitor, in 2013, 24 percent of shareholder proposals submitted at Fortune 250 companies were submitted by two individuals or their family members. Individual shareholders submitted more than 57 percent of the shareholder proposals that went to a vote in 2014. Common retail proposals include:

- splitting the chairman/CEO roles,
- implementing majority voting standards in director elections,
- dismantling takeover defenses, and
- advancing political and social issues.

For many individual retail activists, activism is often a kind of hobby. As such, it can be difficult to negotiate with retail activists because of their dogmatic views on corporate governance or other favorite topics. Nonetheless, retail proposals must be treated seriously. The success of these proposals usually depends on whether the proposals fall within "mainstream" governance trends, which is often influenced by pronouncements coming from the two dominant proxy advisory firms.

State-, Municipal- and Union-Affiliated Pension Funds

State (including municipal) and union pension funds similarly focus on shareholder proposals under Rule 14a-8. These proposals are often aimed at executive compensation and broader governance issues. In some cases, target companies of these proposals are engaged publicly in labor disputes such as union-organizing campaigns or engaged in public disputes with labor unions.

State, municipal and union pension funds are also resorting to litigation against public companies with greater frequency. As with the union activists' shareholder proposals, the litigation does not necessarily relate directly to a labor or governance issue. Instead, pension funds often serve as lead plaintiffs in securities and M&A class action litigation. Many of these activists work with sophisticated class action lawyers, and "books and records" inspections are often precursors to a derivative or class action complaint.

While these groups generally will not engage in more aggressive activist techniques, they are often supportive of those (such as hedge funds) that do.

Social and Policy Investors

A third category of activists that focuses primarily on the use of shareholder proposals under Rule 14a-8 includes social and policy investors. These groups—often affiliated with religious orders, universities, think tanks, charitable foundations and certain non-governmental organizations (NGOs)—frequently invest in public companies not for the primary purpose of obtaining long-term economic returns, but to gain a platform to change the way those companies conduct business. Frequent topics that social and policy investors make the subject of shareholder proposals include environmental, human rights, executive compensation, supply chain, "sustainability reporting" and political issues. These groups espouse a range of views all along the political spectrum. Social and policy investors often use the shareholder proposal as a way to increase attention to their organization and its agenda. They often wage parallel public relations campaigns against target companies in an effort to discredit management and damage the corporate reputation.

How does a company respond to a shareholder proposal under Rule 14a-8?

The first step in responding to a shareholder proposal is understanding who the proponent is. While there are many well-known repeat players, from time to time new proponents surface. Although proponents are required to submit proof of beneficial ownership with their proposal, many companies seek to independently confirm those holdings. Researching whether the proponent has submitted proposals at other companies or made public statements about the topic of the proposal is also prudent.

[20] The use of the term "retail" investor is not intended to connote someone who invests in a retail establishment that sells consumer products, but instead is meant to differentiate an unaffiliated individual investor from an entity investor affiliated with a sophisticated institution of some kind.

Moreover, the company should review institutional investor views and proxy advisor governance policies concerning the proposal to estimate likely investor support.

A company must then assess whether it agrees with the substance of the proposal. In some cases, companies choose to take action to implement the proposal without the need for a shareholder vote. In that case, many proponents will voluntarily withdraw the proposal. Substantial implementation of the proposal is one of the grounds for excluding it from the company proxy statement under SEC rules.

At times, a company will see some merit to a proposal, but not wish to implement it fully. In that situation, a negotiation with the proponent will often ensue. If a compromise is reached, the proponent will again typically agree to withdraw the proposal. Substantial implementation of a proposal is also grounds for exclusion under SEC rules.

Finally, a company way wish to exclude the proposal on one of several grounds permitted under SEC rules and interpretations by the SEC staff. As a threshold matter, Rule 14a-8 lays out specific eligibility rules for the proponent (such as minimum ownership and timeliness of submission), and a company should assess whether those rules have been satisfied. If not, the proposal can usually be excluded from the company proxy statement. The rules also lay out thirteen substantive grounds for exclusion. Among the potential grounds for exclusion include matters relating to a company's ordinary business, proposals that are materially false or misleading, and proposals the company lacks the power to implement.

A company seeking to exclude a shareholder proposal on one of the permitted grounds must notify the SEC in writing of its decision to do so and provide an analysis of its reasoning. Many companies also seek affirmation from the SEC staff, in the form of a "no-action" letter, that the staff does not object to exclusion. Depending on the type of proposal, the SEC staff may decline to issue the no-action letter. Each year, a small number of public companies and their shareholders proceed to federal court and litigate the appropriateness of including the shareholder proposal in the company's proxy statement.

Are there other allies of the issue-focused activist?

In recent years, an entire industry focused on supporting the issue-focused investor has emerged. Various players compete to publish reports, white papers, "best practices" and uniform standards on a range of topics facing public companies. For example, an affiliate of ISS (the proxy advisory firm) produces various reports purporting to assess corporate governance, executive compensation and similar policies at individual public companies. Several other groups have produced model disclosure standards on corporate "sustainability." Still others publish "scores" or "rankings" of public companies based on the authors' own assessment of corporate disclosure or other corporate policies. Issue-focused activists frequently cite these sorts of materials in support of their agendas.

At first blush, many of these materials appear to have a patina of objectivity. But on closer inspection, it becomes apparent that the authors of these materials often write from an ideological point of view consistent with the one advanced by the issue-focused activist. The authors often do not distribute these reports broadly to the public, and if they are even available for purchase, they can be expensive and may require the purchaser to agree not to share the report with others. Moreover, the authors frequently employ proprietary methodologies that they do not fully reveal to the public. Each of these factors makes independent fact-checking difficult or impossible. Companies should not hesitate to point out this opaqueness and the lack of objectivity of these materials as they seek to rebut the activist who cites them.

What is current state of public policy surrounding issue-focused shareholder activism?

Generally, state laws set the parameters for the corporate governance requirements of an incorporated company, including that a company's board of directors oversees the management of a company, and that shareholders can vote to elect directors and to approve major corporate transactions, among other activities. Since many shareholders do not attend the annual shareholder meetings, voting often occurs through proxies solicited prior to the shareholder meetings. The SEC regulates the process of communicating with shareholders through the proxy materials under Section 14 of the Securities Exchange Act of 1934.

The most recent legislative changes to the proxy voting process came from the 2010 Dodd-Frank Act, which required public companies to hold nonbinding shareholder votes on executive compensation at least once every three years. Another provision of the Act authorized the SEC to adopt proxy access rules that would give shareholders an easier path to nominating an alternative slate of directors for a shareholder vote by allowing these shareholder nominations to be included in the corporate proxy materials. After a majority of the SEC approved proxy access rules, the rulemaking was challenged in court and the federal Court of Appeals for the District of Columbia Circuit struck down the rules in 2011 as being "arbitrary and capricious."

The activist community continues to expand in size and scope. Investment-focused activists in the hedge fund industry in particular have developed a great deal of momentum and show no signs of slowing down. Companies hoping the storm will blow over soon are likely to be disappointed. Instead, the best defense is a good offense. Get to know your shareholders, assess and address vulnerabilities in advance, and have a team of advisors at the ready. If—and when—an activist comes calling, your company will be prepared to engage head on.

Glossary of Legal and Financial Terms

Arbitrage Strategy
An arbitrage strategy seeks to exploit small price differences in a particular asset derived from inefficiencies in the market for that asset.

Beneficial Ownership
A person "beneficially owns" a security under SEC rules when the person directly or indirectly shares voting power or investment power (the power to sell) with respect to the security. The beneficial owner can be, but is often not, the person who holds legal title to the security as its record owner.

"Classified" Board of Directors
See "Staggered" Board of Directors.

"Collar" Transaction
A trading strategy that involves simultaneously purchasing call options and selling put options on company stock.

Derivative
A "derivative" is a kind of financial instrument that derives its value from the performance of an underlying asset such as a particular security, financial index, commodity (like gold or silver) or interest rate. Some types of derivatives are traded in public markets just like stocks, and others are bespoke contracts entered into with a bank or other sophisticated counterparty.

Equity Derivative
An equity derivative is a kind of derivative whose value is tied to the performance of one or more company stocks.

Event-Driven Strategy
An event-driven trading strategy seeks to exploit one-off occurrences or transactions, such as the announcement of a merger or a company's entry into bankruptcy. Shareholder activism is a kind of event-driven strategy.

Hedge Fund
"Hedge fund" is a term used to describe a broad category of private investment partnerships that seek to out-perform the stock market by employing proprietary investment strategies for the capital they manage on behalf of investors. Hedge funds often seek to capitalize on unique research, investment theories and market analysis that other money managers have overlooked or do not have the resources to conduct on their own. Most hedge funds seek to raise investment capital only from sophisticated institutional investors such as pension plans, charitable endowments, foundations and "family offices" that manage funds on behalf of wealthy individuals and their families.

"On the Shelf" Rights Plan
An "on the shelf" rights plan (or poison pill) includes a draft of all key documents that are prepared in advance but not executed so that the rights plan may be implemented quickly should the need arise.

Option
An option is a kind of derivative and is defined as the contractual right to buy or sell an asset (such as a share of stock) at a future date at a pre-determined price. A "put" option is the right to sell, and a "call" option is the right to buy.

Poison Pill
A "poison pill," also known as a shareholder rights plan, is an anti-takeover device. A poison pill makes it prohibitively expensive to seek an unsolicited change in control of a company because additional shares of stock are distributed to all other shareholders as soon as a potential acquirer purchases a set number of shares without the target company's board's consent.

Proxy Contest
A "proxy contest" is a contested director election in which the company and an insurgent group each nominates its own candidates for the board of directors, and each group circulates its own proxy card to shareholders for voting for those candidates at the meeting.

Regulation FD
An SEC rule that limits the ability of a public company to make selective disclosure to one recipient of information without making simultaneous disclosure to the investing public.

Retail Investor
An individual investor that is a natural person and unaffiliated with a sophisticated institution of some kind.

Rule 14a-8
An SEC rule that permits certain eligible shareholders to include a proposal for action at the company's annual meeting of shareholders in the company's own proxy statement.

Shareholder Rights Plan
See "Poison Pill".

"Staggered" Board of Directors
Under a "staggered" or "classified" board of directors, directors serve multi-year terms and only stand for election every two or three years, depending on the number of director classes. Unlike a declassified board, in which directors serve one-year terms and must be re-elected annually, a staggered board makes it impossible for an insurgent to replace the entire board in a single election.

Tender Offer
A tender offer is a public offer to shareholders inviting them to surrender or "tender" their shares in exchange for a cash purchase price. Because the tender offer is made directly to the company's shareholders, it does not require approval or consent of the target company board of directors

Wolf Pack
A group of hedge funds that act in pursuit of a common activist investment goal without overt communication or coordination among one another.

About the National Association of Manufacturers

The National Association of Manufacturers is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all fifty states. Manufacturing employs nearly twelve million men and women, contributes more than $1.8 trillion to the U.S. economy annually, has the largest economic impact of any major sector, and accounts for two-thirds of private-sector research and development. The NAM serves as the voice of the manufacturing community and is the leading advocate for a policy agenda that helps manufacturers compete in the global economy and create jobs across the United States.

About Hunton & Williams LLP

Founded in 1901, Hunton & Williams LLP blends more than a century of experience in virtually every key legal discipline with a broad view of current business realities and a forward-looking perspective on emerging issues, to provide legal and regulatory advice that serves our clients well. We are regularly named by legal and business publications as among the top law firms for client service and as a best place to work.

Hunton & Williams LLP has a long history of boardroom level relationships, and we understand the importance of establishing and maintaining effective, efficient and responsive boards of directors. We are well-versed regarding public and private dialogues on governance, oversight, compliance, activism and shareholder engagement issues. We have represented boards of directors and their audit, nominating, governance and special committees; individual directors; and senior executives on a range of corporate governance matters, activist campaigns, investigations, and related issues.

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