Corporate Governance and the New Hedge Fund Activism:
An Empirical Analysis

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Hedge funds are not “normal” institutional investors. They launch proxy fights for corporate control. Their recent successes and “wolf pack” tactics have garnered headlines, but leave us with a question: what does hedge fund activism mean for corporate governance in the United States? This Article undertakes a legal, empirical, and theoretical study in an effort to answer this question. The heart of the Article is an empirical study of obtainable instances of hedge fund activism during 2005 and the 2006 proxy season. The Article starts by showing that the SEC opened the door to hedge fund activism when it stopped censoring most proxy material in 1992 and started allowing proxy “free communication” in 2000. This Article’s empirical survey found over 50 instances of hedge fund activism, and also found the in terrorem effect of these examples to be considerable. The survey further found that the combination of “wolf pack” tactics and the increasing influence of activist proxy advisory firms (the recommendations of which many institutional investors follow automatically) have made hedge fund activists a real power in corporate governance. Despite some claims that hedge funds often hold short positions or are otherwise dangerously conflicted, the survey found very limited evidence for this; the survey also found that hedge funds have, in fact, disclosed these conflicts, though the proxy and Williams Act rules in this respect should be clarified. The Article then subjects these results to theoretical analysis using current nexus of contracts, shareholder primacy, director primacy, team production, connected contracts, and other theories, and finds none completely satisfactory. The Article concludes that an almost unprincipled balance-of-power political model best explains the hedge fund activism phenomenon. In the end, if these activities cause managements to review and reassess their strategies, corporate governance is improved.

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I. INTRODUCTION

After an absence of over a decade, shareholder activism is once again a hot topic, but this time with a difference. Back in the early 1990s, the focus was on institutional investors and whether they could step in and help keep corporate managements in line after hostile takeovers had fizzled a few years earlier. Now “hungry” hedge funds with outsized war chests and egos to match are said to be the “new raiders,” or even the “new sheriffs of the boardroom.” While hedge funds openly posture and threaten, lawyers and
consultants for corporations send their clients memoranda with titles like The New Crisis and (in plainer English) Be Prepared for Attacks by Hedge Funds. Some even believe thatagements and these new activist shareholders are battling for corporate America.

This battle is occurring now for three principal reasons. First, in the past few years, hedge funds have attracted an enormous amount of capital at the same time that returns in their traditional, lower-profile strategies have stagnated. Hedge funds now invest well over $1 trillion, and all that money has to go somewhere. Their investors, moreover, generally expect market-beating or even absolute returns in exchange for the hefty fees most hedge funds charge. The pressure to perform is on. And yet hedge fund industry returns were hardly better than flat in 2004 and amounted to not much more than a market index return in 2005 and 2006. According to one knowledgeable observer, some making landscape.”).


5. See Battling for Corporate America, ECONOMIST, Mar. 11, 2006, at 69 (asking, “Who will come out on top in the renewed struggle between shareholders and managers?”).

6. See, e.g., Erin E. Arvedlund, Easing the Sting, BARRON’S, Jan. 30, 2006, at 46 (citing Burton Malkiel as noting that hedge fund performance appears to have entered “an era of single-digit returns”); Susan Pulliam & Martin Peers, Once a Lone Wolf, Iahn Goes the Hedge-Fund Route, WALL ST. J., Aug. 12, 2005, at A1 (“The quick profits that hedge funds seek are harder to come by now, partly because they’ve exploded in number, resulting in far more savvy investors on the prowl and thus fewer undiscovered values.”); Henry Sender, Hedge Funds: The New Corporate Activists, WALL ST. J., May 13, 2005, at C1 (noting that traditional passive strategies no longer work so “instead of just taking bets on the outcome of others’ moves, [hedge funds] themselves are becoming the catalyst for change in the corporate world”); Thorns in the Foliage, ECONOMIST, Apr. 1, 2006, at 61 (noting that “these days it is becoming harder for hedge-fund managers to make money”).

7. See Lauren Etter, Volatile Markets Bring Hedge Funds Under Fire, WALL ST. J., July 1, 2006, at A9; Lauren Etter, Why Corporate Boardrooms Are in Turmoil, WALL ST. J., Sept. 16, 2006, at A7 (noting that total hedge fund industry assets have reached $1.2 trillion); Growing Pains, ECONOMIST, Mar. 4, 2006, at 63.

8. See Steve Fishman, Get Richest Quickest, N.Y. MAG., Nov. 22, 2004, at 28 (article subtitled “In the precarious hedge-fund bubble, it’s either clean up—or flame out”). Hedge fund fees vary considerably, but often consist of a management fee of up to 2% per year plus a performance fee of 20% or more of profits; mutual fund fees are often 1% with no performance fee. See id.; see also Jenny Anderson, For Hedge Funds, Life Just Got a Bit More Complicated, N.Y. TIMES, Mar. 31, 2006, at C8 (stating that mutual fund fees average 1.4%); Jonathan Clements, What Price Cachet? As Hedge Funds Struggle, Mutual Funds Look Even Better, WALL ST. J., Sept. 20, 2006, at D1 (stating that because “[m]any hedge funds have struggled this year” investors “could be better off with humdrum mutual funds”); Growing Pains, supra note 7, at 64 (noting high hedge fund fees and investor expectations); John Waggoner, Managed Funds Top S&P 500 Index Again, USA TODAY, Jan. 4, 2006, at 1B (noting difficulty of beating market indices).

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funds are consequently “turning to activism because it is getting tougher to show top-notch returns as more hedge funds pursue similar investment ideas and overall market volatility drops.”

Second, in our post-Enron, post-Sarbanes-Oxley world, there may be a greater willingness on the part of investors to hold underperforming managements accountable. And third, as this Article will show, recent legal reforms and court decisions have largely deregulated proxy contests and other shareholder insurgency activities so as to make hedge fund attacks easier and cheaper.

Meanwhile, another more complicated battle is taking place, this time among academic commentators and the corporate community. The issue is the role that shareholders (including hedge funds) play in corporate governance. Lined up on one side are those who believe that shareholders actually own corporations and should have a greater say in how they are run. Shareholders, according to this view, should have direct input in selecting director candidates and even in making other major corporate decisions when directors are not up for election. Against them stand those who distrust shareholders (perhaps especially hedge funds) and believe that companies are best run by directors who supervise professional managers.

stellar” recent hedge fund performance and noting John Bogle’s acid comment that “[y]ou would think someone would be a little embarrassed taking all that money for humdrum returns”). Of course, hedge fund returns are self-reported and leave some wondering about the accuracy of published results. See Floyd Norris, Are These Hedge Fund Results Real?, N.Y. TIMES, Apr. 21, 2006, at C1 (summarizing recent research indicating that reported hedge fund results may be unreliable).


11. See Charles M. Nathan & Erik A. Lopez Sr., Hedge Funds and M&A – New Sharks and Too Little Shark Repellant, in 237TH ANNUAL INSTITUTE ON SECURITIES REGULATION 11, 44 (PLI Corp. L. & Practice, Course Handbook Series No. 1517, 2005) (“In this post-scam decade, the overall mood is oriented toward rooting out corporate misdeeds, an aim which activist hedge funds frequently purport to be seeking.”); Riva Atlas, Some Funds Taking Role Far Beyond Just Investor, N.Y. TIMES, Aug. 16, 2006, at C1 (citing opinion that “[i]n the wake of corporate scandals and passage of the Sarbanes-Oxley Act, it is harder for companies to ignore shareholders’ views”); Pulliam & Peers, supra note 6, at A1 (describing Carl Icahn’s view that “there has been a sea change in investor attitudes concerning the role of entrenched corporate management and that shareholders now “want to hold them accountable”); Thornton, supra note 3, at 32 (“In the wake of Enron and other scandals, companies have never been as vulnerable to shareholder demands as now.”).

12. See infra Part III.


14. See, e.g., Iman Anabtawi, Some Skepticism About Increasing Shareholder Power, 53 UCLA L. REV. 561, 598 (2006) (arguing that directors are best suited to manage corporations because, unlike individual shareholders, they “owe fiduciary duties to all shareholders”); Stephen M. Bainbridge, Director Primacy and Shareholder Dismemberment, 119 HARV. L. REV. 1735, 1758 (2006) (arguing that director primacy has “stood the test of time” and is efficient and that the “current regime of limited shareholder voting rights” should therefore be retained) [hereinafter Shareholder Dismemberment]; Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. 547, 605-06 (2003) (arguing that the “power
stand somewhere in the middle of all this and appear largely to favor the status quo.\textsuperscript{15} Their argument points to the *modus vivendi* constructed by the Delaware courts a generation ago in *Unocal Corp. v. Mesa Petroleum Co.*\textsuperscript{16} and its progeny and basically amounts to the saying, “If it isn’t broken don’t fix it.” In any event, the fundamental question seems to be whether hedge fund activism will accomplish little but generate headlines and disappear like the hostile takeover boom of the 1980s or whether hedge funds can positively influence corporate managements and thereby play a real, lasting, and useful role in American corporate governance.\textsuperscript{17}

This Article contributes to this debate by examining in detail how hedge fund activism actually happens and whether it betters corporate governance. Part II reviews the recent legal history of shareholder activism and examines why 2005, according to one leading proxy solicitation firm, “marked the emergence of hedge funds as a force to be reckoned with in election contests and mergers.”\textsuperscript{18} Part III presents a comprehensive empirical survey of what hedge funds are, in fact, doing and examines how they are doing it. Have the new hedge fund barbarians sacked corporate Rome or are they merely diligent and useful tillers of the corporate governance soil? Part IV explores the implications of the findings presented in Part III, analyzes whether hedge funds are a problem that needs to be fixed, and presents a modest proposal for regulatory reform. Part V then shows how hedge funds do not fit into present-day corporate governance theories and develops a new theory based on a balance-of-power analysis. The Article concludes, as some argued a decade ago in the early days of investor activism, that politics has indeed come to the world of corporate governance\textsuperscript{19} and that hedge fund activists are having a far greater impact than their absolute numbers might suggest.

\textsuperscript{15} See, e.g., Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company’s Proxy: An Idea Whose Time Has Not Come*, 59 BUS. L. 67, 94 (2003) (arguing that proponents of change in how directors are elected “do not make a compelling affirmative case”); A. Gilchrist Sparks, III, *Corporate Democracy: What It Is, What It Isn’t, and What It Should Be*, INSIGHTS, Mar. 2006, at 20, 23 (noting the “overwhelming historical success of the existing governance system”); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764; 1783 (2006) (arguing that managers should be kept free from shareholder interference to manage and noting that “the growing influence of institutional investors . . . has not been an unadulterated good”).

\textsuperscript{16} *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949, 954-57 (Del. 1985) (imposing a higher, “reasonable in relation to the threat posed” standard of judicial scrutiny in cases reviewing director conduct in takeover situations).

\textsuperscript{17} See Stephen Bainbridge, *Hedge Fund Activism* (May 27, 2005), http://www.professorbainbridge.com/2005/05/hedge_fund_acti_1.html (“Are hedge funds the next big thing in corporate governance, solving the principal-agent problems inherent in that governance structure? Or will they fizzle out the way hostile takeovers and, to a lesser extent, institutional investor activism have?”).


II. THE LEGAL FOUNDATIONS OF HEDGE FUND ACTIVISM TODAY

To begin with, there is no legal or even generally accepted definition of a “hedge fund.” According to the Securities and Exchange Commission (SEC), a hedge fund is any privately offered “entity that holds a pool of securities” or other assets and that is not a registered mutual fund.\(^{20}\) Perhaps many people simply think of hedge funds as secretive, aggressive, anything-goes investors.\(^{21}\) For purposes of this Article, the term includes plain vanilla hedge funds as well as other “fellow traveling” funds with a similarly aggressive activist investment style. But for any investor, SEC and related rules form a veritable slalom course that must be run in any proxy fight or other shareholder activism effort. These rules have essentially been reworked twice in recent years, first in 1992 with the avowed purpose of making traditional large-institution activism easier,\(^{22}\) and then again near the turn of the millennium to streamline merger and acquisition transactions.\(^{23}\)

As the following pages will describe, however, the surprising consequences of these changes for hedge fund activism have only recently become fully apparent. Two of the changes, the termination of SEC proxy censorship and the free-communication rule adopted in 1999, have essentially revolutionized proxy fights and made hedge fund activism as we know it today possible.

A. The SEC Rules and the 1992 Reforms

Absent an available exemption, any shareholder “solicitation” automatically invokes the full panoply of the SEC’s proxy rules.\(^{24}\) These rules define a “solicitation” as any communication to shareholders “under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.”\(^{25}\) This is a facts-and-circumstances test. Even the SEC has acknowledged that what constitutes a solicitation is therefore “not always clear,” and that “almost any statement of views” could expose a

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22. See infra Part II.A.

23. See infra Part II.B.


shareholder to litigation risk. Cautious lawyers consequently advise their clients accordingly.

Complying with the rules means filing a proxy statement and card in preliminary form with the SEC for review by the staff. Once all comments are cleared, the shareholder is free to mail its materials to all or as many other shareholders as it wishes. Identifying these other shareholders and coping with the truly Byzantine complexity of actually reaching them through brokerage firm and other Wall Street back offices then necessitates hiring a financial printer and a professional proxy solicitation firm, which only adds to the legal expenses already incurred. But from here things get easier. After distributing the proxy statement, nothing else that an insurgent sends out has to be pre-cleared with the SEC, as had been the case before the 1992 reforms. According to the adopting release, the SEC got itself out of the proxy censorship business because it believed that contestants “should be free to reply to [an opponent’s] statement in a timely and cost-effective manner, challenging the basis for the claims and countering with their own views on the subject matter through the dissemination of additional soliciting material.” This change has proved to be revolutionary. Restained only by the general proxy antifraud rule, a hedge fund activist is now free to disseminate to the world near telephone books full of essentially unverifiable presentation slides.

There are two genuinely useful exemptions from these shareholder solicitation rules: the ten-or-fewer rule, and the free-speech rule adopted as part of the 1992 reforms. The ten-or-fewer rule allows a contestant to solicit freely up to ten other shareholders without filing anything with the SEC, and can be extremely valuable in the early stages of getting an insurgency campaign off the ground. In situations where ownership is fairly concentrated, this first effort can sometimes even prove determinative. The free-speech

28. Unlike companies, which have to mail materials to everyone, shareholders can generally mail to as many shareholders as seems tactically expedient. See Internet Availability of Proxy Materials, Exchange Act Release No. 55,146, 72 Fed. Reg. 4148, 4158 (Jan. 29, 2007) (commenting that dissidents can save costs by soliciting only “those with large holdings”).
31. 17 C.F.R. § 240.14a-6(a) & (b) (2006).
36. On one recent occasion, an insurgent was able to win a contested vote on a ten-or-fewer basis alone. See American Building Control, Inc., Schedule 13D (June 21, 2004); American Building Control, Inc., Current
rule allows an insurgent to solicit an unlimited number of holders without filing anything with the SEC, except a copy of any written materials. The insurgent must use management’s proxy card and generally cannot intend to engage in a proxy solicitation for the election of directors or any other “control transaction.” Nevertheless, the rule enables an insurgent to run an inexpensive campaign for or against any proposal already appearing on management’s proxy card. Hedge fund activists principally use the rule to attack unwanted mergers.

The remaining useful proxy reform is the “short slate” rule. Although rarely used, the rule permits a dissident to run a slate of fewer directors than there are seats up for election. A shareholder simply sends out a proxy card naming its own nominees plus those management nominees for whom it will not vote, thereby casting a vote for all available seats. The strategic thought here is that running a short slate permits a less confrontational, constructive engagement with management, while at the same time seeming less risky and therefore more attractive to an institutional voting base.

Apart from the proxy rules, the other regulatory hurdle facing a would-be insurgent is the SEC’s Schedule 13D and its accompanying rules. The two main issues are the “group” issue and the “intent” issue. Corporate defense lawyers generally look here first for litigation fodder.

These rules require the filing of an ownership report on Schedule 13D within ten days after the acquisition of 5% or more of a company’s stock. Any two or more persons will be considered one aggregated filing group if they have agreed to act together

Report (Form 8-K) (June 22, 2004) (filings reflecting the replacement of company chairman in a contested election). The author represented the shareholder in this situation. See also Crouch v. Prior, 905 F. Supp. 248 (D.V.I. 1995) (granting preliminary injunction for soliciting over ten shareholders); Briggs, supra note 1, at 102-10 (providing detailed analysis of ten-or-fewer shareholder solicitations).


42. See Ronald J. Gilson et al., How the Proxy Rules Discourage Constructive Engagement: Regulatory Barriers to E lecting a Minority of Directors, 17 J. CORP. L. 29 (1991) (article that led to the adoption of the short slate rule).


45. The filing rules are succinctly summarized in THOMAS R. STEPHENS, BENEFICIAL OWNERSHIP REPORTING: SCHEDULES 13D AND G, at A-3 to -18 (BNA Corp. Practice Series No. 68 (2003)).
“for the purpose of acquiring, holding, voting or disposing” of the shares.\textsuperscript{46} And “holding” or “voting” most assuredly includes the concept of threatening to vote.\textsuperscript{47} The agreement need not be in writing, may be informal, and may be inferred from circumstantial evidence. The real-world problem most frequently encountered here is determining when discussions among shareholders about influencing company strategy or the make-up of management ripen into a disclosable agreement to form a group. The cases are legion, and generally leave even the most knowledgeable lawyers wondering where exactly to draw the line for their clients.\textsuperscript{48}

Still more cases concern the “intent” issue. Schedule 13D calls for the disclosure of any “plans or proposals” concerning an entire laundry list of corporate events, including mergers or other extraordinary corporate transactions, changes in the board of directors or management, asset sales, or anything else similar to the enumerated items.\textsuperscript{49} Any material change in these plans then requires the “prompt” filing of an updating amendment to the Schedule.\textsuperscript{50} Again, the real-world problem most frequently encountered is determining when brainstorms, mere suggestions, and other preliminary ideas ripen into disclosable plans or proposals. The cases here, too, are legion.\textsuperscript{51} Perhaps the safest conclusions are that a shareholder must absolutely disclose all definitive plans and that any undisclosed plans had better not show up in the garb of outwardly seeming definitiveness when discovery occurs and depositions are taken.

\textbf{B. The Turn-of-the-Millennium Changes}

Although these proxy and Schedule 13D rules remain with us today, several important changes over the past few years have operated to blunt their regulatory impact and help fuel the recent surge of hedge fund activism. Judicial decisions have also contributed to these developments as the courts have continued to work through applying precedents largely developed during the take-over boom of the late 1970s and 1980s to the more ordinary rough-and-tumble of shareholder activism.

By far the most important change, really a revolutionary change, was the addition in late 1999 of a new Rule 14a-12 to the proxy rules as part of the promulgation of Regulation MA for take-over transactions.\textsuperscript{52} So long as no proxy card is furnished, Rule 14a-12 effectively allows unlimited solicitations before any proxy statement is filed. Written materials must be filed with the SEC upon their first use, must disclose all the participants in the proxy solicitation and their shareholdings, and must contain prescribed

\begin{itemize}
  \item \textsuperscript{46} 17 C.F.R. § 240.13d-5(b) (2006).
  \item \textsuperscript{47} See Briggs, supra note 1, at 112-17.
  \item \textsuperscript{48} See id. (providing a comprehensive analysis); infra notes 63-71 and accompanying text (update).
  \item \textsuperscript{50} 17 C.F.R. § 240.13d-2(a) (2006).
\end{itemize}
legends. Oral communications, according to the adopting release, are also freely
permitted and “do not need to be reduced to writing and filed.”53 Of course, a participant
must truly intend to prepare and disseminate a proxy statement.54 But if the solicitation is
abandoned, there never will be any proxy statement.55 (Cynics might detect a wink here.)
It also goes without saying that a proxy participant can send all this information out to
shareholders and the press.56 By the time an actual proxy statement is finally ready to
mail, more than a few fights will already be practically over or settled entirely.57

Another recent modernization of the proxy statement delivery rules should make it
much easier and cheaper to finish any proxy fight that does not settle, and may prove
equally revolutionary.58 After moving the public offering regulatory regime under the
Securities Act to an internet-access-equals-delivery model in 2005,59 the SEC has
likewise moved the proxy disclosure system to a notice-and-internet-access model.60 For
a dissident shareholder, simply emailing or otherwise sending a short Notice of Internet
Availability of Proxy Materials will constitute sufficient notice.61 The proxy statement
itself will only have to be posted on the dissident’s website and emailed or mailed to
requesting shareholders, if any. “We [therefore] anticipate,” the SEC concluded with
perhaps considerable understatement, “that the notice and access model . . . may decrease
significantly the printing and mailing costs associated with a [dissident’s] proxy
solicitation.”62

The SEC similarly streamlined the Schedule 13D rules in 1998 when it added a new
category of ordinary “passive” investors, such as hedge funds, to those eligible to file an
abbreviated disclosure statement on short-form Schedule 13G.63 The principal benefits of
the abbreviated form over the longer Schedule 13D are that it generally requires updating
only once a year and that it calls for no disclosure at all about an investor’s purpose or
intentions; contrariwise, a Schedule 13D has to be amended promptly for any material

54. See DIV. OF CORP. FIN., SEC, MANUAL OF PUBLICLY AVAILABLE TELEPHONE INTERPRETATIONS, at
Part I.D, Question No. 3 (Supp. III 2001), available at http://www.sec.gov/interp/phonesupplement3.htm (“In order to rely on Rule 14a-12, soliciting parties must intend to furnish a proxy
statement to security holders.”).
55. See Securities Act Release No. 7760, supra note 35, at 61,415 (“[P]arties relying on the rule are not
obligated to furnish a written proxy statement if the solicitation is discontinued for any reason.”).
56. Securities Act Release No. 7607, supra note 52, at 67,340; see also Eugene F. Cowell III, Internet
Technology Permits New Proxy Contest Techniques, InSIGHTS, Oct. 2001, at 17 (summarizing internet
distribution techniques under Rule 14a-12).
57. See GEORGESON SHAREHOLDER 2005, supra note 18, at 4 (noting decline in all-out proxy fights “as
management frequently decided to reach settlements with their dissident shareholders rather than risk a full-
scale battle”).
58. See Exchange Act Release No. 55,146, supra note 28 (adopting release); David A. Katz & Laura A.
McIntosh, A Seismic Shift in Mechanics of Electing Directors?, N.Y.L.J., July 27, 2006, at 5, 7 (noting that
dissident costs will be “significantly diminished”).
(Aug. 3, 2005) (adopting regulations modifying communication and prospectus delivery requirements).
61. Id.
62. Id. at 4158.
Fed. Reg. 2854 (Jan. 16, 1998). Note that such a passive investor’s ownership level also has to be under 20%.
Id.
change and requires detailed purpose and intent disclosure. The obvious strategic benefit of using the short form Schedule 13G is that it allows for a surprise attack: with no “purpose” disclosure and only annual ownership disclosure, who can really tell what is going on until, as at Pearl Harbor, it is too late? There is an equally obvious flip side to this question: When exactly does such an investor become non-passive and so have to switch from a Schedule 13G to a Schedule 13D? The SEC noted in its adopting release that such a determination can be “difficult and fact intensive.” As a practical matter, however, it seems that merely making suggestions to management about what it should be doing is perfectly permissible, while seeking board representation, proposing an acquisition, or otherwise making threats is not.

The courts have also contributed to streamlining the rules for hedge fund activism. From a tactical point of view, the most important development is their continued reluctance to find undisclosed groups lurking amidst shareholders who merely talk to one another and have frank exchanges of views about their investee companies. In *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, for example, the Second Circuit refused to find that two Schedule 13D filers and a Schedule 13G filer were a group just because one was a known raider, two bought stock during the same period, and all three discussed what to do about their investment. Based in part on *Hallwood*, another court found that a flurry of investor emails and even a joint slate of directors among the investors were not enough to create an undisclosed group. “Congress,” said the court, “did not intend for Section 13(d) to serve merely as an eleventh-hour bludgeon for management embroiled in proxy contests.” Decisions such as these have enabled hedge funds to engage in “wolf pack” tactics against companies undeterred by a fear of somehow magically becoming a group merely because they hunt together and seek the same prey.

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64. If, however, an investor’s ownership exceeds 10%, additional Schedule 13G amendments are required for any 5% change. 17 C.F.R. § 240.13d-2(d) (2006). The Schedule 13D amendment rule, at 17 C.F.R. § 240.13d-2(a) (2006), provides, among other things, that a 1% change in an investor’s ownership level is material, and thus requires an amendment.


68. *Id.* at 616-18.


70. *Id.* at 633.

71. See *infra* Part III.B.2. From the point of view of a management-side observer, “[t]his form of parallel action, driven by numerous independent decisions by like-minded investors, as opposed to explicit cooperation agreements among participants, has allowed hedge funds to avoid being treated as a ‘group’ for purposes of Regulation 13D.” Nathan & Lopez, *supra* note 11, at 41. On the other hand, truly egregious flouting of the “group” rule could lead to being on the wrong end of an SEC enforcement action. See *In re John Joslyn,*
These wolf packs, moreover, can often have an influence far out of proportion to their actual shareholdings because of recent regulatory action mandating responsible fiduciary proxy voting by institutional investors. Another, more succinct name for this phenomenon might be the Rise of Institutional Shareholder Services (ISS). ISS got its start in the late 1980s when the Department of Labor, which supervises pension funds, ruled that “[t]he fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies . . . .”72 The SEC then joined the party in early 2003 when it adopted rules mandating that registered investment advisers vote proxies “in the best interest of clients” and that registered mutual funds disclose both their proxy voting policies and how they actually voted.73 As a practical matter, cost effective compliance has meant hiring someone else to vote the shares, namely ISS. And ISS has a distinctly activist bent.74 For example, its current voting policies support only the weakest kinds of poison pills75 and only then if shareholders ratify them within a year. ISS also mandates voting against all board members of all companies that deviate from this approach.76 More critically, in contested board elections and other corporate disputes, ISS has become increasingly willing to support dissident candidates and positions.77

ISS and its competitors have, in fact, become enormously influential and have also helped weaken corporate defenses. Although it is difficult to quantify ISS’ precise impact, a recent Business Roundtable survey concluded that an average of 40% of its responding members’ shares were owned by institutions that followed ISS voting recommendations.78 One consultant has similarly noted that “[m]any firms, especially

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74. See Inst. S’holder. Servs., ISS 2006 US Proxy Voting Guidelines Summary (2006) [hereinafter ISS Voting Guidelines], http://www.issproxy.com/pdf/US2006SummaryGuidelines.pdf (summary of voting policies). By 2004, the chairman of The Business Roundtable, a leading corporate lobbying group, had become so frustrated with ISS’ perceived anti-corporate bias that he urged the founding of a competitive alternative to ISS. “We have all seen,” he said, “the increasingly hostile recommendations from existing proxy advisory firms who continue to promote narrow interests at the expense of long-term shareholder value.” Gretchen Morgenson, Pfizer and the Proxy Adviser, N.Y. Times, Apr. 21, 2006, at C1 (quoting Hank McKinnell, the chairman of the Business Roundtable). But ISS is less active than it used to be. See J.P. Donlon, ISS Signals Strengthened Standards, Directorship, Mar. 2006, at 1, 9-10 (“ISS originally had a public image of being an activist organization, but this isn’t so today.”).

75. A poison pill can be adopted by a board of directors without a shareholder vote and is intended to make a hostile takeover economically ruinous for the acquiror. See Black, Shareholder Passivity Reexamined, supra note 2, at 550-51.


77. See ISS Voting Guidelines, supra note 74, at 14 (proxy contest guidelines are case-by-case). Specific examples are given below, at infra Part III.B.2.


those that practice purely quantitative or index investing, will vote in line with ISS’ recommendations . . . [while] some firms claim they vote on a case-by-case basis but will always vote with ISS.” Getting a favorable ISS recommendation is therefore frequently essential to victory. The ISS voting guidelines and evolving shareholder views have also gone some way to taking the sting out of corporate takeover defenses, including weakening poison pills and staggering boards so that all directors stand for election every year. In short, the ISS phenomenon has furthered and encouraged shareholder activism of all sorts, especially hedge fund activism.

Finally, a series of recent decisions by the Delaware courts, where most public companies are incorporated, has preserved for hedge fund activists the right to enjoy the fruits of electoral victory. Shareholders’ voting rights occupy a special place in


80. See infra Part III.B.2.; see also Andrew R. Brownstein & Trevor S. Norwitz, Shareholder Activism in the M&A Context, 10 M & A L.J., June 2006, at 1, 3 (noting that ISS “cannot be regarded as a neutral party” and that the “fusion of aggressive hedge fund activism and the power of large institutional holders is a potent formula that can energize an activist campaign”); Shawn Tully & Doris Burke, Proxy Muses, FORTUNE, Dec. 25, 2006, at 159, 162 (“ISS generally holds the cards in close contests.”).


82. ISS has also become significantly conflicted because it sells its activist-oriented services to institutions (creating issues for corporate managements) and to corporations (solving the issues created). See Institutional Shareholder Services, Inc., SEC No-Action Letter, [2004 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,845 (Sept. 15, 2004) (failing to get a blanket waiver of these conflicts under the Investment Advisers Act). ISS’ power and conflicts are attracting increasing notice. See, e.g., NEW YORK STOCK EXCH. PROXY WORKING GROUP, REPORT AND RECOMMENDATIONS 29 (2006), http://www.nyse.com/pdfs/PWG_REPORT.pdf (recommending formal SEC study of “the role these [proxy advisory] groups play in the proxy voting process”).

83. Kent Greenfield, Democracy and the Dominance of Delaware in Corporate Law, LAW & CONTEMP. PROBS., Autumn 2004, at 135, 135-37 (observing that over half of all U.S. public companies and over 60% of the Fortune 500 are incorporated in Delaware).
The only discouraging word here is Sarbanes-Oxley. Finding candidates willing to serve on a dissident slate has always been difficult, and this bit of what Roberta Romano has called “quack corporate governance” has not made this task any easier. The SEC’s implementing rules have also cast a dark shadow of non-“independence” over any candidate put up by a holder of 10% or more of a company’s stock. And as anyone who has read this far no doubt already knows, “independence” is the key to the Sarbanes-Oxley corporate governance city.

86. See MM Cos., 813 A.2d at 1121 (involving new board vacancies created as a defensive measure); Chesapeake Corp. v. Shore, 771 A.2d 293, 297 (Del. Ch. 2000) (involving adoption of a supermajority bylaw provision).
89. See Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521 (2005); see also Barry Augenbraun, Should Directors Be Worried?, INsIGHTS, Feb. 2005, at 21 (rationally asking why any executive would choose to serve on a public company board and why any lawyer would advise such service “in today’s climate”); Steven A. Seiden, Calling Those With Fortitude: So You Need a Dissident Director, BUS. L. TODAY, Jan.-Feb. 1999, at 29 (finding dissident director candidates).
90. Standards Relating to Listed Company Audit Committees, Securities Act Release No. 8220, 68 Fed. Reg. 18,788 (Apr. 16, 2003) (adopting Rule 10A-3, 17 C.F.R. § 240.10A-3 (2006), which provides that only ownership under 10% preserves independence). Others have noticed this absurdity, too. See Roberta S. Karmel, Realizing the Dream of William O. Douglas – The Securities and Exchange Commission Takes Charge of Corporate Governance, 30 DEL. J. CORP. L. 79, 141 (2005) (observing that a corporation’s large stockholders nonetheless have “the greatest incentive to assure” high compliance standards). But the New York Stock Exchange’s listing standards have no such bright-line test. See NEW YORK STOCK EXCH., LISTED COMPANY MANUAL, Rule § 303A.02 & commentary (2004), available at http://www.nyse.com/lcm (noting that “as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding”).
III. EMPIRICAL STUDY AND REVIEW: HEDGE FUND ACTIVISM

All these legal changes have combined to open the door for a new, more aggressive kind of shareholder activism, and hedge funds have marched unhesitatingly through. The following pages examine what they actually do and how they do it.\(^92\)

A. Study Methodology

The methodology used is straightforward. Data for all 2005 (the first year hedge fund activism received widespread notice) and the first eight months of 2006 (both the cut-off for this Article and the unofficial end of the proxy season) were hand-gathered from press reports and information available from ISS and Georgeson.\(^93\) What is considered a “hedge fund” has already been described.\(^94\) For purposes of the study, “hedge fund activism” is defined as any actual or overtly threatened proxy contest or any other concerted and direct attempt to change the fundamental strategic direction of any solvent United States public corporation other than a mutual fund. For example, any campaign using such phrases as value “maximization” or “enhancement” is included; conversely, mere sponsors of corporate governance shareholder resolutions are excluded.\(^95\) Once a situation was identified, virtually every filing with the SEC by every participant was reviewed to obtain details (which often remain under or unreported) about the strategies and tactics used.\(^96\) While diligent efforts were used to identify as many situations as possible, some have no doubt been missed. This is likely especially true for situations involving smaller companies or sparser press attention.

Although the data presented have not been deliberately “cherry picked” for hedge fund success, unsuccessful activist efforts and campaigns involving smaller companies inevitably garner less than their fair share of attention. A campaign that gets no traction dies unnoticed. Some subjective judgment is also involved here since every hopeful writer of a “Dear Management” letter, who might get noticed in the weekly Barron’s write-up of that week’s half-dozen or so “activist” Schedule 13D filers, can hardly be said to have mounted anything resembling a real campaign. Nevertheless, what follows is presented with the confidence that it is indicative of the kinds of strategies and techniques

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92. A summary of the data collected appears as the Appendix at the end of this Article (Appendix: Hedge Fund Activism, January 2005 – August 2006).


94. See supra notes 20-21 and accompanying text.

95. If sponsoring shareholder resolutions constituted activism, then even Harvard law professors could be activists, as well as the usual run of labor unions, public pension funds, and full-time corporate gadflies. See Mark Maremont & Erin White, Stock Activism’s Latest Weapon, WALL ST. J., Apr. 4, 2006, at C1 (reviewing innovative shareholder-resolution-based activist techniques used by Professor Lucian Bebchuk against eight public companies); see also infra notes 209-214 and accompanying text (reviewing labor union, public pension fund, and individual activism through shareholder resolutions).

96. Essentially all public company filings are available, sorted chronologically by company, through the SEC’s EDGAR search page, http://www.sec.gov/edgar/searchedgar/webusers.htm.
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actually used by hedge funds today. The relevance of these findings for corporate governance and regulation then follows in Parts IV and V.

B. The Findings: Hedge Fund Activism Today

Despite all the press and attention lavished on hedge fund activism and its supposed evils and benefits, one of the most striking things about this study’s findings is how rarely activist efforts became full public attacks. Of the thousands of U.S. public companies, only 52 seem to have become the subject of a significant hedge fund campaign during the 20 months examined. So whatever the eventual significance of hedge fund activism, today it represents less of a direct meaningful problem for management America than an indirect sign of a coming fundamental change in U.S. corporate governance.97

1. Free Communication

As intimated in the legal introduction above,98 the most striking substantive finding is that Rule 14a-12’s “free communication” provisions have transformed the hedge fund shareholder activism landscape. Of the 41 situations involving threatened or actual proxy or consent fights, the dissidents used the rule for written communications in 30. The 11 remaining situations mostly involved either unusual circumstances, such as a hostile consent solicitation (where the surprise attack is the favored tactic), a mainly verbal campaign against an unwanted merger, or a fast settlement.99 The funds’ use of Rule 14a-12, moreover, has sometimes become so extreme that an entire proxy contest has occurred without the filing of any proxy statement at all, not even a preliminary one. Carl Icahn and the management of Time Warner fought it out for six months on the basis of Rule 14a-12 filings alone, finally culminating in an Icahn-led press conference at the St. Regis hotel in New York and a 348-page book full of supporting material presented by Icahn’s investment banker, the venerable Bruce Wasserstein.100 After all this, Icahn retired to count the votes he likely had, determined that they were not enough, and threw in the towel after a barely face-saving settlement—two new independent directors and an increase in the company’s existing stock buy-back program.101 How could all this happen, practically a whole proxy contest, with no proxy statement? The second extreme Rule 14a-12 contest found in the study, Relational Investors’ ten-month campaign against

98. See supra text accompanying notes 52-57 (discussing “free communication” SEC filing requirements).
99. See, e.g., infra text accompanying note 133 (settlement after consent solicitation at AirNet Systems); infra, text accompanying notes 104 and 140 (oral campaign against merger at MCI); infra text accompanying note 147 (fast settlement at Knight Ridder). Strangest of all was General Motors, where the insurgent claimed it was passive and yet somehow managed to threaten a proxy contest anyway to obtain a board seat. See Lee Hawkins, Jr., Kerkorian May Turn Up Heat on GM, WALL ST. J., Sept. 22, 2005, at A3. For the tactics in consent solicitations, see Eric S. Robinson, Defensive Tactics in Consent Solicitations, 51 BUS. LAW. 677 (1996).
101. See Matthew Karnitschnig, Time Warner, Icahn Reach Accord, WALL ST. J., Feb. 18, 2006, at A3 (discussing the settlement and noting Ichan’s failure to “win one of his biggest demands”).
Sovereign Bancorp, was at least conducted based in part on the filing of a preliminary proxy statement.\textsuperscript{102} Two other important aspects of the Rule 14a-12 phenomenon are worth noting. First, months-long contests with all sorts of material being distributed to shareholders ineluctably involve frequent and extensive conversations with those being solicited. As described above, entire hotel ball rooms full of shareholders can be addressed. Under Rule 14a-12, these conversations remain essentially unregulated.\textsuperscript{103} The study found one contest, Deephaven Capital Management’s unsuccessful attempt to block the MCI-Verizon merger, where a hard-fought campaign appears to have been based solely on oral communications.\textsuperscript{104} Second, with the SEC no longer prescreening any of this material, sophisticated and one-sided advocacy rules the day.\textsuperscript{105} Certainly getting practically daily filings over a period of months, let alone a 348-page financial presentation book, past the SEC never would have happened on anything like a real-time basis before the rules modernization.\textsuperscript{106}

\section*{2. Activist Size, Wolf Pack Tactics, and the Advisory Firms}

After the near ubiquity of Rule 14a-12, the study’s next most interesting finding is the size of the funds’ direct and indirect shareholdings. Of all the situations reviewed, only five involved hedge fund activists with less than a 4.9\% stake. Twenty-six activists had at least a 9.5\% stake.\textsuperscript{107} A higher stake makes for a bigger publicity megaphone and gives any campaign a good start when it comes to counting votes. It also helps to have fellow, like-minded investors with still more shares. Three of the situations studied show disclosed ownership by a handful of institutions of over half the outstanding shares.\textsuperscript{108} Failing this kind of already locked-up vote, an activist can attract a “wolf pack” of

\begin{itemize}
  \item \textsuperscript{102}See Jesse Eisinger, Sovereign Bancorp’s Takeover Deal Looks Like a Dis to Shareholders, WALL ST. J., Nov. 2, 2005, at C1 (summarizing the contest, including Relational’s preliminary proxy filing); David Enrich, Sovereign, Relational Crusaded Right up to Their Uneasy Truce, WALL ST. J., Mar. 24, 2006, at C3 (describing the settlement).
  \item \textsuperscript{103}See supra text accompanying note 53.
  \item \textsuperscript{104}See Andrew R. Sorkin & Ken Belson, A Campaign to Derail Verizon-MCI Deal, N.Y. TIMES, June 15, 2005, at C2 (discussing the “three-month battle for MCI”). The insurgents never filed any written material under Rule 14a-12.
  \item \textsuperscript{105}See supra text accompanying notes 31-33 (noting the SEC’s changes that eliminated pre-clearance of all proxy material except the proxy statement itself).
  \item \textsuperscript{106}See Regulation of Security Holder Communications, Exchange Act Release No. 29,315, [1991 Transfer Binder] Fed. Sec. L. Rev. (CCH) ¶ 84,811, at Part II.B.1 (June 17, 1991) (noting that both “management and insurgent groups alike have criticized [preclearance] . . . as interfering unduly with effective communication with shareholders”). For an authoritative account of the old preclearance procedures, see Edward Ross Aranow & Herbert A. Einhorn, Proxy Contests for Corporate Control 138-59 (2d ed. 1968).
  \item \textsuperscript{108}It is also highly likely that there were many more than only three. Professional proxy solicitors make part of their living by using the often stale and always difficult-to-interpret information provided by Form 13F reports under Rule 13f-1, 17 C.F.R. § 240.13f-1 (2006), to estimate ownership by institutions that stay under the 5\% level used for Schedule 13D, Schedule 13G, and proxy statement disclosure purposes.
\end{itemize}
other hedge funds interested in the same prey but who are careful not to form a Schedule 13D group. Precise data about wolf packs are impossible to obtain since ungrouped holders do not have to disclose anything, but at least several of the situations studied appear to have involved these beasts. Thirteen involved either two or more mutually supportive but separate Schedule 13D filers or other reported pack activity. In the two-week long successful effort to force a sale at Knight Ridder, for example, the company’s largest shareholder was joined just two days after the announcement of its campaign by two other new Schedule 13D filers with the same goal. What started out as a 19% stake effectively grew to 37% in just 48 hours. The campaign had succeeded almost instantly.

From a purely legal point of view, it is especially noteworthy that two of these packs produced a joint slate of directors while somehow avoiding forming a group. This kind of close but non-group forming pseudo-cooperation would have been inconceivable in a prior era, and shows how intimate shareholders can get without running afoul of the rules. Note, too, that in the Bally proxy fight the company attempted to sue on this point in both federal and state court, but to no avail.

The ISS phenomenon described earlier appears to help add wolves to the pack. ISS backed the dissidents in 13 proxy fights for board seats and the dissidents won 12; ISS backed management in four other contests, one of which the dissident also won. Although its published proxy contest guidelines reflect a case-by-case policy, in practice ISS appears more than willing to back dissidents. When it does, they win. Or at least it has to help since whenever elections are involved, every vote counts. Even if ISS’ evident policy of issuing a recommendation only two weeks or so before a scheduled proxy vote means that it misses most situations, its known leanings will inevitably influence everything from pre-proxy value maximization campaigns to outright proxy contest settlements. After all, how contestants think a vote will likely go will inevitably drive their settlement decisions.

ISS’ previously described indirect influence on antitakeover defenses also appears to have fatally weakened one of the predated companies in the survey, Six Flags, Inc. The dissident in this contest was able to mount a consent solicitation to take over effective control of the board of directors because the company’s charter failed to prohibit a consent solicitation. Since only the shareholders can amend ...

109. See supra text accompanying notes 45-48 (discussing filing requirements for shareholder groups), and 63-71 (discussing legal aspects of hedge funds’ wolf pack tactics).
110. Compare Briggs, supra note 1, at 137-38 (providing detailed legal analysis), with supra text accompanying note 69 (citing a recent case appearing to allow a joint slate).
112. See supra text accompanying notes 72-82.
113. See supra note 77 and accompanying text.
114. This conclusion is drawn from the study data. Situations missed include settled fights (if the contest stops early enough) and generic value enhancement or maximization campaigns (no vote at all).
115. See supra text accompanying notes 78-82 (describing ISS’ indirect influence on antitakeover defenses).
a charter, Six Flags would have needed to have had its shareholders vote to take away from themselves the right to act by consent. ISS has a policy of always recommending a vote against such a charter amendment.117 Current investor sentiment these days also generally runs in the same direction. So trying to fix the vulnerability would have been futile, and the company remained open to an activist’s attack.

The object nevertheless remains to persuade, and it appears that hedge fund activists are taking advantage of their opportunities in new ways. ISS has come to be treated almost as a sort of latter-day cross between Solomon and the Pied Piper of Hamelin before which contestants make road-show financial presentations and, in at least one instance, purely legal arguments.118 Four activists in the survey took the essentially unprecedented step of hiring high-profile investment bankers.119 And it seems that sophisticated slide shows, duly filed with the SEC, have become standard practice. One activist went so far as to prepare a formal white paper.120

3. Other Findings

Money also helps any campaign and, as described in the Introduction above, hedge funds now have a lot of it.121 Four hedge funds have used their financial clout to offer to buy their targets outright, perhaps more in the hope of shaking things up than in actually completing a transaction.122 A fifth actually did so. In a somewhat aggressive use of the new short-form Schedule 13G rules for passive investors,123 Edward Lampert’s ESL Investments (ESL) negotiated a purchase of Sears, Roebuck and Co. over a period of several weeks without disclosing anything at all.124 Then, only after the acquisition agreement was actually signed, was a full Schedule 13D filed.125 ESL did get sued over

Section 228 of the Delaware General Corporation Law permits shareholder action by written consent unless the charter specifically prohibits such action. Del. Code Ann. tit. 8, § 228 (2001). Other “pure” shareholder solicitations in the survey were directed against companies subject to Colorado and Ohio corporate law, which statutorily give shareholders the right to call a special meeting, and against a New York company with an old, similarly permissive, bylaw. See Computer Horizons, Inc., Definitive Proxy Statement (Schedule 14A) (Sept. 14, 2005) (filed by the Computer Horizons Full Value Committee) (requesting shareholders to remove incumbent directors and to elect the Committee’s nominees).

117. See ISS Voting Guidelines, supra note 74, at 15.

118. Cenveo, Inc., Definitive Additional Materials (Schedule 14A) (Aug. 24, 2005) (filed by Burton Capital Mgmt., LLC) (letter brief submitted to ISS presenting dissident’s case on directors’ fiduciary duties); see Tully & Burke, supra note 80, at 160 (ISS staff is “constantly meeting with management and dissidents”).

119. See Der Hovanesian, supra note 3, at 72 (observing that activists are “recruiting new allies on Wall Street,” and citing the investment banks hired in the Wendy’s and Time Warner situations); Gregory Zuckerman, Activist Hedge Funds Win Fans on Wall Street, WALL ST. J., May 8, 2006, at C1 (citing the investment banks hired in the Six Flags and Axiom situations).


121. See supra text accompanying notes 6-7.


123. See supra text accompanying notes 63-66.


125. See Sears, Roebuck and Co., Schedule 13D (Nov. 19, 2004) (filed by ESL Investments, Inc.) (cover-
this tactic—buying a whole company as a supposedly “passive” investor—but by then it was too late. The acquisition was already an accomplished fact.

At this point, another of the survey’s findings necessarily enters the discussion: for all its public-relations nastiness, hedge fund activism rarely results in campaign-time litigation. Although several situations appear to have involved significant law suits, only three of them appear to have been company-instigated. It is not hard to guess why. Many knowledgeable observers believe that suing hedge fund activists is “more likely to alienate other shareholders these days.” Just two of these disputes produced truly full-out litigation. The court proceedings in the Sovereign Bank contest basically went nowhere, but left the insurgent struggling with only mixed success against Pennsylvania’s particularly unfriendly corporate regime. The company’s poison pill and Schedule 13D “group” lawsuits in the Bally contest, on the other hand, seemed actually to help the insurgents.

Finally, the survey found hedge fund activists using a number of other tactics that will already be familiar to close observers of the shareholder activism scene. The short slate rule adopted with the 1992 proxy reforms, described earlier, apparently continues to see little actual use, as it appears only three times. Written material under the 1992 “free speech” rule appears in only one contest. Another dissident used a public solicitation of consents to call a special meeting (the dissident by itself did not own enough shares) in an ultimately successful attempt to bluff management into a settlement. And on at least two occasions, dissidents used Hart-Scott-Rodino antitrust page box indicating a switch from Schedule 13G to Schedule 13D is checked).

126. Such a result is possible if the investor only becomes definitively non-passive ten days or less before filing a Schedule 13D. See supra text accompanying notes 45-51 and 63-66. As of this writing, the litigation over whether ESL was really passive while it relied on Schedule 13G is pending. See Levie v. Sears Roebuck & Co., No. 04C7643, 2006 U.S. Dist. LEXIS 12725, at *19 (N.D. Ill. Mar. 22, 2006) (denying motion to dismiss).

127. Phyllis Plitch, Lawyers See No Poison Pill To Feed Hedge Fund ‘Wolf Packs,’ CORP. GOVERNANCE, Dec. 21, 2005, at 4, 19 (summarizing views of Wall Street lawyers); see Katz & McIntosh, supra note 4, at 7 (noting lack of recent anti-hedge fund litigation and commenting that “a scorched-earth litigation campaign may alienate important shareholders and turn the tide against management”); Briggs, supra note 1, at 135-36 (subsection entitled “Litigation: the New Risk Calculus”).


129. After the threatened filing of the suits, the principal dissident’s fight letters regularly cited them as an example of the company’s “poor judgment, and noted that they also apparently helped influence ISS to recommend voting for the dissidents. See, e.g., Bally Total Fitness Holding Corp., Definitive Additional Material (Schedule 14A) (Jan. 17, 2006) (filed by Pardus European Special Opportunities Master Fund, L.P.) (fight letter prominently noting ISS’ disapproval of the company’s “extremely rare” and “potentially extreme” attempted application of its poison pill to thwart a stockholder vote in a proxy contest).

130. See supra text accompanying notes 40-42.


IV. CONFLICTS OF INTEREST AND FULL DISCLOSURE

The central question running throughout any examination of hedge fund activists is this: Can we trust them?\textsuperscript{135} According to critics, they are short-term traders whose interests frequently diverge from those of a company’s other shareholders.\textsuperscript{136} Worse still, their secretive and complex trading strategies can sometimes mean that they actually may want a company’s strategies to fail.\textsuperscript{137} There is indeed practically a whole catalogue of possible disclosed and undisclosed sins that a hedge fund (or anyone else) might commit in the course of an activist campaign, and hedge funds seem to have been accused of committing them all.\textsuperscript{138} Based on the data gathered in the survey, however, there appears to be very little fire beneath all this smoke, and what there is seems largely contained by present-day regulations.

A. Hedged and Other Adverse Positions

Perhaps the most serious charge that can be leveled at hedge fund activists is that their trading strategies may encourage them to destroy corporate value rather than create it. What could possibly be worse for the other shareholders, especially if they have no inkling that their activist hero is really short the stock?

The survey found very little evidence of these kinds of games, just six possibly questionable situations. In three of these, the activist had a trading position in a merger counterparty: ESL at Sears was long and supported the merger; Icahn at Mylan Labs was short and opposed it; and Deephaven at MCI was short and also opposed it.\textsuperscript{139} Only notification filings, which are generally required only of active investors, to indicate their seriousness of purpose as an apparent prelude to starting settlement discussions.\textsuperscript{134}
Deephaven seemed to provoke skepticism on the part of other investors, and this may have been because the fund further disclosed positions both in MCI’s bonds and in a competing acquirer’s stock and bonds. Deephaven’s campaign consequently seemed profoundly, almost impenetrably, tactical and therefore failed to win the support of either ISS or many other investors. Evidently MCI’s investors could read, and they were not easily led astray.

Two of these six activists were hedged, and leave the disinterested observer wondering whether all politics must indeed be local. The dissident fund in a proxy contest for three board seats at Exar Corporation last year disclosed that it held less than one percent of the stock and that 96% of the shares were “boxed” or fully hedged with offsetting short positions. The dissident was thus almost completely indifferent to how the company performed since a “boxed” position is capable of generating no further profit or loss; nevertheless, ISS recommended a vote for the fund anyway and it won. The seemingly far more complicated situation with Carl Icahn’s advisee in his contest at Time Warner, on the other hand, seems to have been interpreted as nothing more than a clever way of acquiring an interest in the most shares for the least risk and cost. The sixth activist, the author of the value enhancement white paper in the Wendy’s campaign, disclosed that its interest in the company was mostly in privately negotiated put and call options that appear to have been entered into as a short-term financing device. Here, too, the complexity of the dissident’s position seems to have caused little comment or concern.

The allegedly value-destroying short term approach of many hedge funds activists is harder to analyze, but again seems to cause little concern for other investors. As noted in Part I, hedge funds are under intense pressure to perform now, today, but this does not exactly make them all that different from many other Wall Street institutions. Even

140. See MCI, Inc., Current Report (Form 8-K) (Oct. 7, 2005) (reporting that the merger received the support of 88% of the votes cast and 65% of the stock outstanding).
143. See Schedule 13D, supra note 120.
144. See generally Andrew R. Sorkin, An Investor Takes Aim at Wendy’s, N.Y. TIMES, Dec. 13, 2005, at C1 (discussing how today’s corporate boards are no longer resisting at all costs “activist investor[s]” who are “changing corporate America and the deal-making landscape”).
145. According to one hedge fund manager, “the ‘short-term’ versus ‘long-term’ distinction is often a nonsensical cover-up for poor performance from managers who have failed to deliver results over either horizon.” Barry Rosenstein, Activism Is Good for All Shareholders, FIN. TIMES, Mar. 10, 2006, at 17. Many academic commentators also seem unconvinced by the supposed evils of short-term investing. See, e.g., MARK J. ROE, STRONG MANAGERS, WEAK OWNERS 242-43 (1994) (characterizing “short termism” as little more than a “debater’s weapon” deployed by defenders of corporate managers). Some even actively defend short-termism. See, e.g., Joe Nocera, A Defense of Short-Termism, N.Y. TIMES, July 29, 2006, at B1, B8 (“[F]or all the anecdotal evidence of short-termism and its effects, there is not a lot of empirical data to back it up.”). On the other hand, an SEC commissioner recently questioned “whether . . . short-time investors should be entitled to shareholder rights in outright conflict with long-term investors.” Roel C. Campos, SEC Commissioner, Remarks before the SIA-Hedge Fund Conference (Sept. 14, 2005), available at http://www.sec.gov/news/speech/spch091405rcc.htm.
146. See supra text accompanying note 8.
the most obvious and public short-term versus long-term conflict in the survey apparently
drew little or no publicly reported fire from other investors: the dissident in the Knight
Ridder sell-the-company campaign was widely said to be angling for a $300 million
performance bonus payment from its corporate parent, but few seemed to care. Knight
Ridder was sold anyway, and for a price that many felt was disappointing.\footnote{See Joseph T. Hallinan \\& Dennis Berman, \textit{Knight Ridder to Decide on Sale}, WALL ST. J., Mar. 13, \\2006, at A2 (summary of transaction); Katharine Q. Seelye, \textit{What-Ifs of a Media Eclipse}, N.Y. TIMES, Aug. 27, \\2006, § 3, at 1, 7 (noting the “lack of interested buyers” in this “cautionary tale” of decline and fall); Joseph T. \textcolor{red}{Hallinan, Legg-Mason-PCM Deal Included Payout Pact That May Explain Timing on Knight Ridder Push, WALL ST. J., Nov. 23, 2005, at C1 (noting approaching deadline for $300 million bonus performance measuring period).}}

Although the corporate governance literature is full of dire warnings about how
large shareholder activists might seek to divert corporate monies to themselves, the
survey did not find evidence of any more direct adverse hedge fund behavior, such as
greenmail or other similar conflicts. Several hedge funds in the survey managed to get
some of their proxy contest expenses reimbursed, but this has been normal and customary
practice for decades.\footnote{See, e.g., Anabtawi, supra note 14, at 593-97 (discussing the potential impact of shareholder activism on overall shareholder value); Bernard S. Black, \textit{Agents Watching Agents: The Promise of Institutional Investor Voice}, 39 UCLA L. REV. 811, 855-61 (1992) (discussing the “common worry . . . that institutional money managers will use their power to divert part of the corporate income stream to themselves”); Rock, supra note 135, at 995-99; see also David A. Skeel, \textit{Corporate Anatomy Lessons}, 113 YALE L.J. 1519, 1529 (2004) (noting that in places like Germany and Japan “[b]lockholders may use their influence to direct benefits to themselves at the expense of the company’s other, scattered shareholders”).} Only one fund appears to have become involved in a more complicated situation. Barrington Capital started out with a board seat at Register.com, lobbied unsuccessfully for a sale, and then started a proxy contest for control. Barrington Capital ended up abandoning its proxy contest partner in mid-fight, settling for the reimbursement of up to $500,000 of its expenses, and joining the company’s cash-short eventual acquirer as an equity participant. The company’s special committee evidently
pushed hard for the settlement and seems to have worked to squeeze every last ounce of
possible juice from the buying group.\footnote{See Register.com, Inc., \textit{Definitive Proxy Statement (Schedule 14A),} at 5-8, 18 (Sept. 20, 2005).} Nothing in this admittedly somewhat involved situation appears to resemble greenmail.\footnote{Possible hedge fund impropriety once in control of a company’s board presents a different set of problems. \textit{See infra text accompanying notes 254-259.}}

\textbf{B. Full Disclosure of Adverse Positions}

The review thus far of hedge fund activism has shown that hedge fund activists
rarely pursue strategies that cannot withstand the light of day.\footnote{The only doubtful case turned up is MCI. \textit{See supra text accompanying notes 139-140.}} But we really should not
be surprised. Hedge funds know as well as anyone else that sunlight is the best
disinfectant. With only one recent known exception,\footnote{\textit{See infra text at notes 166-168; lanthe J. Dugan, \textit{Hedge Funds Get Warning on Use of Merger Move, WALL ST. J., Jan. 11, 2006, at C1 (reporting that one of the funds involved in the Mylan-Icahn situation has received a Wells notice from the SEC’s enforcement division questioning the fund’s Schedule 13D disclosure.}}} a competently advised fund that
is truly bent on behavior that might not do well in the sun is simply not going to purchase enough shares to require a Schedule 13D filing, let alone start a high-profile proxy fight. It necessarily seems to follow that current SEC disclosure laws as applied to hedge fund activists already effectively require full disclosure of doubtful trading strategies,154 or much of this Article would not exist. But how true is this, and could the rules stand some improvement?

The disclosure rules in Rule 14a-12 battles and outright proxy fights require only a brief analysis.155 Based on a review of all the proxy filings in the survey, it would seem that the SEC’s existing rules mandate the disclosure of essentially everything that a hedge fund might otherwise want to keep secret. Any other view would be practically unthinkable. As authoritatively interpreted by the United States Supreme Court, the SEC’s proxy antifraud rule mandates the inclusion of all “material” facts, and a fact is deemed material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”156 As we have seen, lawyers who draft proxy statements for activist hedge funds think that people would want to know if their clients own bonds or are short, hedged, or invested in the other side of a proposed transaction.157 Moreover, the Second Circuit apparently agrees.158 It recently stopped a proxy solicitation from going forward under the “free speech” rule (that is, without a proxy statement) at least in part because it was not satisfied with how the dissident hedge fund had disclosed its short derivative position in a merger counterparty’s bonds. The court rather dryly observed that the hedge fund’s interests in defeating the company’s proposed merger consequently “may or may not be in sync with the interests of other . . . shareholders.”159 The actual proxy statement line-item disclosure requirement in this area then becomes almost beside the point. It rather inadequately references only “securities of the [company] which the [proxy] participant owns” and therefore remains an almost quaint remnant of a prior, simpler time.160

If there is a 5% shareholder but no proxy statement, Schedule 13D rules the day, and here the analysis gets somewhat more complicated. Schedule 13D requires an investor to disclose any “contracts, arrangements, [or] understandings . . . with respect to any securities of the company in addition to, as described earlier, its true purpose and intentions in holding the stock.”161 Disclosure of short positions,162 cash-settled

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154. Whether current SEC disclosure regulations sufficiently police ordinary hedge fund trading activity is an extraordinarily complex question beyond the scope of this Article. See Hu & Black, supra note 29; Kahan & Rock, supra note 138 (describing the influence of hedge funds, including their trading activity, on governance).

155. The same information about proxy participants’ shareholdings is required to be included, directly or through incorporation by reference, in Rule 14a-12 material as in a full proxy statement. See 17 C.F.R. § 240.14a-12(a)(1) (2006) (regulating solicitation before distribution of a proxy statement).


157. See supra Part IV-A.


159. Id. at 148.


derivatives, and positions of any kind in a proposed merger counterparty, are not directly called for. But in the context of a high-profile activist effort, the “purpose” disclosure requirement in fact covers just about the same waterfront as the proxy rules just discussed. After all, if a filer is hedged, short, or otherwise conflicted, it is at least doubtful that this would not affect its purpose in holding the stock. The SEC has warned that a short or futures transaction may constitute “a possible shift in purpose” under the rules. The only shareholder activist in recent memory known to have skirted the rule is Perry Corporation in the Carl Icahn-Mylan Labs situation previously mentioned. Perry’s extraordinarily opaque filing disclosed that it had purchased nearly 10% of Mylan on a fully hedged basis, that it also owned shares in Mylan’s proposed merger partner, and that it supported the merger, but did not say how it had hedged. Wall Street observers immediately understood that Perry was effectively buying votes to support a merger Icahn opposed, but the SEC is nonetheless apparently bringing civil enforcement proceedings. The conclusion that Schedule 13D effectively calls for as full disclosure from a hedge fund activist as the proxy rules therefore seems sound.

If there is a 10% shareholder, the SEC’s insider ownership reporting rules do specifically require disclosure of derivative positions as well as direct stock ownership, and outlaw short sales entirely. The rules do not cover straight debt or holdings in other companies. More to the point, many hedge fund activists choose not to exceed the

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163. A purely cash-settled derivative is evidently not a contract “with respect to any securities of the company,” and is generally, in the author’s experience, not disclosed absent special circumstances. See Hu & Black, supra note 29, at 868 (similarly concluding that purely cash-settled derivatives are not ordinarily disclosed). But the SEC has issued a preliminary interpretative release in a closely related context stating that a purely cash-settled security future “would be a ‘contract . . . with respect to . . . securities of the [company]’ under Item 6.” Securities Act Release No. 8107, 67 Fed. Reg. 43,234, 43,240 (June 27, 2002).

164. Although Schedule 13D does not require any disclosure at all with respect to securities of another company, such a second filing of course would be required if the other position independently reached the 5% filing threshold and otherwise fell within the ambit of the rules.


166. See supra text accompanying notes 139, 153.

167. See Mylan Labs., Inc., Schedule 13D (Nov. 29, 2004) (filed by Perry Corp.).


The insider reporting rules therefore play but a minor role in hedge fund activism, especially in light of the already fairly complete disclosure mandated by Schedule 13D and the proxy rules just described.

Finally, as this Article has shown, hedge fund activism with an ownership level below the 5% Schedule 13D threshold only happens relatively rarely. It is not hard to see why. An activist with such a small stake typically has a commensurately difficult time gaining enough attention to find its way into this Article’s database at all, let alone enough attention and (if need be) votes actually to succeed on the merits. A small shareholder activist also suffers proportionately more than a large one from collective action and free-riding problems. In other words, an activist “bears most of the cost of a proxy campaign, but receives only a pro rata share of the gains from success, while other shareholders can free ride” on the activist’s efforts. Certainly from a current regulatory perspective, the Williams Act and the SEC’s implementing Schedule 13D rules endorse the view that shareholders with less than a 5% stake pose so little threat to corporate management and independence that they are simply not worth bothering with. This Article’s comprehensive survey of publicly disclosed activism in 2005 and 2006 has found little or nothing to gainsay this judgment.

C. Reforming the Adverse Position Disclosure Rules

So what needs to be fixed? It would be easy to conclude from the preceding examination of hedge fund activism problems and the related proxy and Schedule 13D disclosure rules that the problems are mostly contained. However, experienced lawyers will have already detected some straining. The current rules work not because of their fundamentally sound design or elegantly crafted line-item requirements. They work because of the general antifraud rules and the well-founded fear of proxy statement and Schedule 13D drafters that leaving out something important (though not directly called for by the line items) would be a very bad idea. A far better approach would be to fix the line items of the rules so that they work well on their own.

170. See supra note 107. Only 15 activists in the study owned over 10% of their target companies.

171. See supra text at note 107.

172. See John Pound, Proxy Contests and the Efficiency of Shareholder Oversight, 20 J. Fin. Econ. 237, 260 (1988) (providing an empirical confirmation of the commonsense proposition that, in a proxy contest, “[d]issident chances are significantly increased by . . . higher dissident holdings”).

173. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, Voting in Corporate Law, 26 J.L. & Econ. 395, 402 (1983) (observing that “[t]hose who have more shares . . . do not face the collective action problem to the same extent” as those with fewer shares).

174. Black, supra note 148, at 821; see also George W. Dent, Jr., Toward Unifying Ownership and Control in the Public Corporation, 1989 Wis. L. Rev. 881, 903-04 (arguing that high proxy contest expenses exacerbate collective action problems); Mark J. Roe, A Political Theory of American Corporate Finance, 91 Colum. L. Rev. 10, 13 (1991) (because a large shareholder “could capture a [larger portion] of the gains, the large shareholder would often have the incentive to act, an incentive [smaller] fragmented shareholders lack”).

175. See, e.g., Filing and Disclosure Requirements Relating to Beneficial Ownership, Securities Act Release No. 5925, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,571, at 80,300 (Apr. 21, 1978) (reviewing the legislative and regulatory history of the Williams Act, and noting that the statute and rules are directed at “rapid accumulations of . . . equity securities in the hands of persons who would then have the potential to change or influence control” of a public company); Comment, Section 13(d) and Disclosure of Corporate Equity Ownership, 119 U. Pa. L. Rev. 853 (1971) (summarizing the Williams Act’s legislative history).
Proxy statements and Rule 14a-12 filings both require the same participant ownership information and present the easiest case. Any activist engaged in a “solicitation” is subject to their requirements and, as explained earlier, the SEC and the courts define and apply this term quite overbroadly. The real question then becomes how to fix the current rule’s outdated reference only to beneficial ownership of company securities, that is, to securities over which the participant has voting or dispositive control. The problems empirically observed in Part IV.A above and the section 16 derivatives disclosure rules described in Part IV.B above then provide the six-part answer: First, section 16’s well-known and encyclopedically comprehensive derivatives disclosure regime also should apply to proxy filings. Second, short positions should be disclosed. Third, the rule should explicitly confirm that it covers all debt or other obligations or any other item in the company’s capital structure, even those that might not technically constitute a “security.” Fourth, the entirety of the rule should reciprocally apply to ownership relating to any actual or known would-be merger or other extraordinary transaction counterparty. Fifth, the rule should have a catch-all, like Schedule 13D’s reference to “[a]ny [item] similar to any of those enumerated above.” And finally, the rule should require a plain statement of the practical effect of the positions disclosed, such as to establish a hedge, to buy votes, or to create an incentive to support or oppose a proposed transaction requiring a shareholder vote. Taken together, all these changes should clarify the rule’s application considerably without altering anything fundamentally.

Schedule 13D disclosure actually presents two separate issues: who files and what gets disclosed. Since this Article has found nothing wrong with the 5% filing threshold, the first issue reduces to how to perform the percentage calculation. And here there appears to be only one sensible answer: include derivatives. A hedge fund, for example, that held 3% of a company’s shares “in prime broker” (that is, outright) and 3% “in swap” (that is, an economic interest held through a derivatives contract) would thus find itself captured by the reporting system. Although the inclusion of purely cash-settled derivatives would surely require a statutory change, in this day and age there really is little excuse for any lesser approach.

Once a Schedule 13D is required, the simplest and most consistent reform would be to incorporate the proxy rules changes just described. The risk, however, is that doing so might create a horrific and unnecessarily tangled mess out of many otherwise plain vanilla filings. Or, stated differently, not every Schedule 13D represents a potential instance of inadequately disclosed “hedge fund activism” run amok. There probably is no easy answer. Perhaps the best solution is to add an “if material” qualifier to the new disclosure requirements and to provide a safe-harbor list of situations deemed immaterial. There would be no reason, for example, to require disclosure of positions completely extraneous to the “purpose” of the investment as specifically set forth in the Schedule. Perhaps the best that can be said of the details here is that they would no doubt benefit

176. See supra text accompanying notes 24-26, 52-57.
178. See supra note 169.
180. See, e.g., Hu & Black, supra note 29, at 867-71 (recommending inclusion of derivative positions after extensive analysis).
mightily from the notice-and-comment rulemaking process.

V. BALANCE OF POWER POLITICS AND CORPORATE GOVERNANCE

Plainly, hedge-fund activists have a role to play in corporate governance. This Article has shown that, when they choose to get involved, hedge funds can be a real force with which to be reckoned. The question then becomes how they fit into current corporate governance theories and, more practically, whether they improve governance or worsen it. The answer requires a look at hedge funds both as shareholders without more and (assuming proxy contest or settlement success) as shareholders with direct board representation.

A. Hedge-Fund Activism Matters

Given how infrequently this Article has found that hedge funds do get directly involved, does hedge-fund activism matter?

Whatever else might be uncertain in our post-Enron world, there would appear to be little room for doubt on this point: We should care about hedge fund activism because the people who run and advise U.S. public companies care. In other words, those most directly affected by takeovers and proxy fights tell us we should care. According to Martin Lipton’s recent advice to his clients, for example, “[t]he current high level of hedge fund activism warrants the same kind of preparation as for a hostile takeover bid.” The press reports reviewed in the Introduction tell the same story, albeit in somewhat over-wrought terms. Delaware Vice Chancellor Leo Strine has similarly noted “the power of a good example” and predicted that “[r]eplacing a few poorly performing boards will have substantial, beneficial ripple effects on the performance of other boards.” Evidently the increasing frequency of publicly reported instances of direct hedge-fund activism is having a still broader, more important, in terrorem effect on an indeterminately wider universe of public companies.

Many successful hedge fund activism negotiations and settlements also happen behind the scenes with little or no publicity. It is still true, as Michael Useem wrote a decade ago, that “[o]pen struggles for control draw attention but also mislead . . . [because] most of the traffic between managers and investors transpires out of sight.” This kind of quiet activism can be thought of as a kind of Napoleonic military campaign.

181. An interesting recent 20-year study has found that “there is less need for takeover-related discipline to be applied to target firms when a higher level of monitoring is already in place, as indicated by a higher proportion of outside directors and/or greater [shareholder] blockholdings.” Omesh Kini, William Kracaw & Shehzad Mian, The Nature of Discipline by Corporate Takeovers, 59 J. Fin. 1511, 1512 (2004).
183. See supra text accompanying notes 3-12. For a fairly typical example of hedge-fund hype, see Battling for Corporate America from the normally staid ECONOMIST, supra note 5, at 69 (calling activist hedge funds “rampaging shareholders”).
185. See Pound, supra note 19, at 1056-57 (observing that private negotiations “provide the most efficient and effective starting point for influencing the policies of incumbents”).

It is not only the actual battles you fight that count. Real battles cost casualties and money. Battles that the other side can be made to think you are ready to fight matter just as much. Since unfought battles are much cheaper than real ones, you can fight more of them, but with the same expenditure of scarce manpower, time, and money. And quiet, unpublicized shareholder settlement victories are victories nonetheless.

Empirical and other academic studies that review only “proxy fights” while excluding pressure campaigns and most contest settlements miss this considerably larger universe of shareholder activism entirely, and consequently unintentionally understate its significance. In 2005, for example, only 10 of the situations in this Article’s survey counted as tracked “proxy fights” in the widely-used Georgeson Shareholder Annual Corporate Governance Review data. Acquiring a better understanding of hedge fund activism means probing deeper into publicly reported hedge fund campaigns—something this Article has taken a first step towards doing—though even then quiet settlements, private negotiations, and some less-reported situations are inevitably missed. It only remains certain that hedge fund activism plays a far more important role in corporate governance than a simple look at the raw numbers would first suggest.

B. Activist Hedge Funds As Shareholders

Taking the reality of all this hedge fund activism and trying to fit it into the various corporate governance theories that have been worked out over the years makes for an interesting exercise. Nothing quite fits.

1. Ownership and Control

As with almost all exercises such as this one, the starting point is the 1932 classic by Adolf Berle and Gardner Means, The Modern Corporation and Private Property, which first clearly articulated and popularized the notion that widely dispersed shareholdings had effectively separated ownership from control in public corporations.

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187. See Carl von Clausewitz, On War 181 (Michael Howard & Peter Paret eds. & trans. 1976) (1832) (subsection entitled “Possible Engagements Are To Be Regarded As Real Ones Because of Their Consequences”); see also David G. Chandler, The Campaigns of Napoleon 163 (1966) (observing that Napoleon “was always eager to gain total victory for a minimum expenditure of manpower and effort” and so consequently “disliked having to force a full-scale . . . frontal battle,” which was “inevitably expensive”).

188. See Reid Pearson & Ken Altman, Hedge Funds and Shareholder Activism, CORP. GOVERNANCE ADVISOR, May-June 2006, at 25 (“Whether the company settles with the fund or the fund wins during a proxy fight, hedge funds are having their demands met.”); cf. Bebchuk, Increasing Shareholder Power, supra note 13, at 878 (arguing that increasing shareholder power “would similarly produce its benefits in large part by influencing management’s behavior rather than by leading to actual interventions,” i.e., voting contests).

189. See, e.g., Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675, 682-86 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=952078 (relying on Georgeson Shareholder data, which exclude all non-contests and contests settled before mailing, i.e., most settled contests); David Kenberry & Joseph Lakonishok, Corporate Governance Through the Proxy Contest: Evidence and Implications, 66 J. BUS. 405 (1993) (presenting a study that excluded settled contests as well as target companies that were not still public and independent five years later).

190. See Georgeson Shareholder 2005, supra note 18, at 44 (list of tracked contests).

191. See supra Part III.A.

“Under such conditions,” Berle and Means wrote, “control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding.”193 By the mid 1970s, the principal concern had become how shareholders (the owners) could control and monitor their agents (the directors and managers) while minimizing the “monitoring costs designed to limit the aberrant activities of the agent[s].”194 Such activities might include almost any imaginable unremunerative sin, including shirking, chasing after perquisites, empire building, and a host of other “rent seeking” crimes. An influential group of scholars writing in this tradition came to see the corporation as a “nexus” or “set of explicit and implicit contracts” among employees, managers and other constituencies, with the shareholders getting “votes rather than explicit promises.”195 According to the theory, “[v]otes make it possible for the investors to replace the managers.”196

This is where the problems begin. What does it mean to “vote” and “monitor” when, by hypothesis, shareholders are too dispersed and beset by the collective action problems discussed earlier really to do either?197 If they were somehow to overcome these problems enough to monitor closely, at what point do they start usurping the management role? And what qualifies them to manage better than the managers themselves anyway? Are board members really mere agents?

2. Shareholder Primacy

The predominant theoretical response to these and other related questions has come to be called “shareholder primacy,” and means basically what the name implies: shareholders should have the ultimate control over the corporation.198 Since this demonstrably happens only rarely in the actual everyday world of uncontrolled public companies, two of the main academic inquiries have been into why shareholders do not have this power, and how to give it to them. The arguments over why shareholders usually remain powerless are extraordinarily complex, but basically boil down to the

193. Id. at 5.
196. Id. at 1421; see also Jeffrey N. Gordon, Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law, 60 U. CINN. L. REV. 347, 348 (1991) (“The most immediate concern is whether shareholders can use their power to change the composition of the board of directors through the election process, thus to monitor corporate activity more closely.”).
197. See supra text accompanying notes 171-75.
198. Eisenberg, supra note 13, at 832; see generally Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439, 441 (2001) (claiming that shareholder primacy has become the “consensus” view and that other views have been vanquished); Adam Winkler, Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History, LAW & CONTEMP. PROBS., Autumn 2004, at 109 (presenting a progressive criticism of shareholder primacy).
collective action problems already mentioned, insufficient incentives, conflicts of interest, legal obstacles, and management power. Institutional investors consequently generally remain unwilling to spend the time and money to exercise their voting rights fully, that is, to launch proxy fights for control. There is no easy fix. The SEC has proposed letting shareholders put their own director nominees on the official company proxy card at the company’s expense; Lucian Bebchuk has taken this one step further and proposed an almost California-like initiative-and-referendum voting procedure that would give shareholders a direct voice in major “rules-of-the-game” decisions currently controlled by boards of directors. The object, in any event, is to help shareholders exercise in practice their power in theory.

For a hedge fund activist, much of shareholder primacy doctrine is already irrelevant or worse, and its fundamental premise that ownership is separated from control seems at best only imperfectly true when it matters most—when the fund is actively investing. A hedge fund that steps in to call the shots for one of its public portfolio companies eliminates the separation and pulls the levers of corporate power directly. By winning board seats, the fund has succeeded in making its voting franchise effective. And as George Dent put it several years ago, an “effective shareholder franchise . . . remed[ies] the separation of ownership and control and, with it, most other corporate governance problems.” Throwing out an incumbent board refutes the “separation” thesis: control rejoins ownership.

Shareholders willing to wage a proxy fight for control are, by definition, not

199. See supra text accompanying notes 173-74.
201. See Anabtawi, supra note 14, at 577-93 (describing the conflicting interests among shareholders); Camara, supra note 1, at 225-42 (describing the motivations of institutional investors).
203. See Black, Shareholder Passivity Reexamined, supra note 2, at 591-95 (summarizing how managers use and abuse their power to control the corporate agenda).
204. See Security Holder Director Nominations, 68 Fed. Reg. 60,784, 60,784 (Oct. 23, 2003) (proposing rules that would have required companies to include shareholder director nominees in company proxy statements); Bebchuk, Shareholder Access, supra note 13 (arguing that shareholders’ power to replace directors should be meaningful). Once dead, this proposal has both acquired new life and attracted new controversy. See Editorial, Board Games, WALL ST. J., Nov. 27, 2006, at A12 (expressing skepticism about proposals that would give shareholders more power in corporate elections).
205. Bebchuk, Letting Shareholders Set the Rules, supra note 13, at 1784-85.
206. See Easterbrook & Fischel, supra note 173, at 396 (criticizing and summarizing this approach as “[t]hings will get better if we step up the efforts to attain real corporate democracy”).
fundamentally deterred by any of the problems with the current proxy and corporate rules that supposedly need fixing. Otherwise they would not be activists. Specifically, they have enough shares not to be stymied by the collective action conundrum, their holdings are sufficiently concentrated and undiversified to provide an incentive to act in a chosen instance, they do not have trouble attracting like-minded and unconflicted hedge-fund and other allies, they are more than willing to pay expensive lawyers to dodge the legal obstacles, and they care as much about management’s power to stop them as General von Rundstedt did about the Maginot Line in the Spring of 1940. Proxy fights cost money, and hedge fund activists can and do pay the price.

Other shareholders are not as willing to pay. The shareholder primacists’ proposed solutions to this problem are downright toxic to hedge funds. The main issue is that recently proposed solutions amount to a subsidy for these other shareholders who either cannot or will not pay their own way and, as Roberto Romano recently observed in a related context, “[i]t is textbook economics that parties bearing the full cost of their actions make better decisions than those that do not.” For a real-life illustration of this point, we need only note the parties using the SEC’s current shareholder proposal rule. Rule 14a-8 lets anyone with only $2000 worth of stock run a 500-word proposal for free in the company’s proxy statement. It is not hard to guess what has happened. The rule has been hijacked by those with non-economic agendas: In 2005, for example, more than half (54%) of the governance proposals came from labor unions, religious organizations, and public pension funds; and another 22% came from individual investors having 10 or more proposals, or in other words professional gadflies. An earlier study of the shareholder proposal process reviewed similar statistics and concluded that “nontraditional” sponsors such as these appear “more interested in utilizing the proxy device as a communication or bargaining tool, rather than maximizing shareholder welfare.” Detailed studies of union and public pension fund activism have reached the same conclusion. No matter what the outcome of the actual votes on these proposals, and even if we assume that shareholders have gotten pretty good at separating the value-enhancing wheat from the social-agenda chaff, the whole to-do nevertheless remains a

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208. See supra Part III; see also Robert C. Pozen, To Regulate or Not?, WALL ST. J., June 20, 2005, at A14 (“With their holdings concentrated in a few stocks, hedge funds often have more financial incentive . . . [for aggressive activism] than mutual funds or pension plans with broadly diversified portfolios.”).


211. See GEORGESON SHAREHOLDER 2005, supra note 18, at 11, 34-37 (detailed figures and tables).


213. See Romano, supra note 200, at 231 (“It is quite probable that private benefits accrue to some investors from sponsoring at least some shareholder proposals. The disparity in identity of sponsors—the predominance of public and union funds . . .—is strongly suggestive of their presence.”); Stewart J. Schwab & Randall Thomas, Realigning Corporate Governance: Shareholder Activism by Labor Unions, 96 MICH. L. REV. 1018, 1023 (1998) (“[W]e suspect that the goal behind some of the union-shareholder activity is to become more involved in strategic decisions. . . . Shareholder activism is a promising way of getting the attention of top management and the board of directors.”); see also Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 COLUM. L. REV. 795, 796 (1993) (noting the vulnerability of public pension funds to “local considerations, such as fostering in-state employment, which are not aimed at maximizing the value of their portfolios’ assets”).

214. See Bebchuk, Letting Shareholders Set the Rules, supra note 13, at 1799-1804 (arguing that
significant waste of time and money. Subsidizing these kinds of non-economic agendas does not seem like the most value-maximizing policy imaginable.

Hedge funds would in any event likely not qualify to receive the subsidy. Any politically palatable consolidated directors’ ballot, including the one that the SEC has proposed, would likely limit access strictly to long-term, passive holders.215 Hedge fund activists are never passive and are frequently short-term to boot. Similarly, Bebchuk’s initiative and referendum proposal would merely empower other large institutional shareholders whose competence, conflict-free judgment, and frequently overtly political or at least non-economic goals may be highly suspect.216 In short, empowering these kinds of other shareholders would inevitably bring unwanted and distrusted competition to the corporate governance table. Hedge fund activists therefore paradoxically practice shareholder primacy but cannot believe in it as an academic theory.

A couple of clarifications are in order here. First, hedge fund activists of course believe in shareholder primacy in the sense that they want ordinary, solvent companies to maximize profits for their shareholder owners, as opposed to benefiting communities, workers, or other so-called stakeholders. Hedge fund activists are shareholders after all. Second, hedge fund activists naturally also believe in shareholder primacy in the who-calls-the-shots sense that shareholders’ desire, say, to tender into a premium takeover offer should not be thwarted by some pill-wielding and perhaps overly paternalistic board. Again, hedge fund activists are mostly shareholders, not directors. The point here is a different one entirely: as outlined in the preceding paragraphs, shareholder democracy or primacy has often come to be little more than code for what amounts to a subsidy for public pension and union funds and for other “normal” institutional investors unwilling or unable to pay their own way with director election campaigns of their own. It is to this last “code” sense of shareholder primacy that hedge fund activists do not subscribe.

3. Director Primacy

The opposite of shareholder primacy is “director primacy,” a theory championed by Stephen Bainbridge and others.217 According to Bainbridge, this approach remains grounded in the fundamental “nexus of contracts” model but treats the corporation as something the board of directors uses to hire “various factors of production.”218 The directors do and should run the show by fiat as “a sort of Platonic guardian.”219 At most, shareholders react to what the board proposes. Director primacy recognizes this shareholder weakness and actually welcomes it: it contributes to director power, which in turn leads to efficient decision-making and greater shareholder wealth.220 Director


216. See, e.g., Anabtawi, supra note 14, at 583-90; Camara, supra note 1, at 232-36; ISS, 2005 POSTSEASON REPORT, supra note 81, at 35-49 (detailing labor and “socially responsible investment” priorities and results).

217. See, e.g., Bainbridge, Means and Ends, supra note 14.

218. Id. at 550.

219. Id. at 550-51.

220. See Bainbridge, Shareholder Disempowerment, supra note 14, at 1735.
primacy very much draws the line between authority and accountability in favor of authority. The shareholders’ right to throw out an incumbent board thus remains only as “an accountability device of last resort.”

Hedge fund activists fit into the director primacy paradigm as paradoxically as they did into shareholder primacy. Although they do not practice director primacy, they must believe in it as an academic theory for three reasons. First, boards actually do run most corporations and any theory that accurately explains reality automatically has some considerable claim to validity. Second, having a strong board in charge is always efficient and usually satisfactory to the shareholders in the sense that activists leave most public companies alone. Third, and most importantly, director primacy provides a theoretical framework for justifying the exclusion of the wider “shareholder activism” community, the big institutions with often even bigger non-economic agendas. What self-respecting hedge fund, for example, would brook for an instant the social and personal agendas often pursued by so many public pension and union funds?

When it comes to actual practice, however, things are very different. Unless an activist hedge fund itself controls a board of directors, it cannot believe in director primacy. Otherwise it would not have become a shareholder activist and would not be trying either to tell the current directors what to do or to replace them outright. For a hedge fund, the shareholders’ right to replace directors is anything but an “accountability device of last resort.”

A glance at the “principal issues” and “result” columns in the Appendix reveals what this actually means. In almost every case, the hedge funds in the study focused on direct economic issues such as blocking or forcing a corporate sale, or otherwise enhancing value with a stock buy-back, asset sale, or other similar effort. Apart from the “end game” corporate sale issue, which would require a shareholder vote in any event, much of this kind of activity necessarily involves assuming a degree of operational control that is fundamentally inconsistent with director primacy. Setting a dividend rate or determining how many shares to repurchase are matters not normally entrusted to the shareholders. Conversely, purely corporate governance issues seem to take a back seat to the economic issues. Destaggering a board of directors, for example, has hedge fund meaning only to the extent that it leads directly to enhanced economic performance for the fund. Like many academics, hedge fund managers evidently remain unconvinced or agnostic on how directly corporate governance issues correlate with economic profitability and higher stock prices.

221. See Bainbridge, Means and Ends, supra note 14, at 605.
222. Bainbridge, Shareholder Disempowerment, supra note 14, at 1750.
223. See, e.g., DEL. CODE ANN. tit. 8, § 141 (2001) (requiring the “business and affairs of every corporation” to be “managed by or under the direction of a board of directors”); Sparks, supra note 15, at 21 & n.8 (collecting cases demonstrating board control over corporations).
224. See Strine, supra note 15, at 1762-64 (arguing that managers should be left free to manage).
225. See supra note 201 and accompanying text.
226. See supra note 213 and accompanying text; see also Chris Young, Hedge Funds to the Rescue, BUS. Wk., July 31, 2006, at 86 (“[L]eft-leaning pension funds have long taken activist stands on pet peeves such as golden parachutes or the labor impact of a proposed deal. Hedge funds, however, maintain a laser focus on shareholder value.”).
227. See supra note 222 and accompanying text.
228. See supra note 200 and accompanying text.
An important variant of the director primacy theme, the “team production” theory, similarly places the board of directors at the center of corporate power. Under this theory, the board acts as a trusted referee or “mediating hierarch” holding sway over all the different team members that contribute to corporate success. Shareholder voting generally plays no role at all except as “a safety net to protect against extreme misconduct.” But a hedge fund concerned with enhancing value through a stock buy-back or with gaining board seats to run a company more profitably is hardly concerned with “extreme misconduct,” or even any misconduct at all. The company’s board of directors might be doing a only adequate job where the hedge fund might believe that a real home run might be possible if only it could step into the batter’s box itself. The originators of the team production theory, Margaret Blair and Lynn Stout, forthrightly admit that their theory does not really work well here, but argue that real shareholder activism and voting does not figure into how most public companies operate most of the time. The findings of the present Article, however, suggest that hedge fund activists have significantly undermined unfettered director power at more than just a few companies, and much of director primacy theory along with it.

Blair and Stout do not stop here. They intriguingly suggest in the conclusion of their path-breaking article that their approach reveals the “fundamentally political nature of the corporation,” and that future scholarship should look into how shareholders and other corporate constituencies use “political tools, in addition to economic and legal tools” to try to capture a larger share of firm profits. Much of the present Article attempts just such an examination of the most active shareholders, namely hedge funds.

4. Balance-of-Power Politics

Evidently none of these theories accurately describes what activist hedge funds do, which brings us to naked balance-of-power politics as perhaps the most accurate way of thinking about how they actually operate. For activist hedge funds, corporate governance seems most like a kind of war with a putatively failing, slothful, or simply ineffective board of directors as the enemy.

The best starting point for this balance-of-power analysis might be the almost nihilistic “connected contracts” metaphor outlined a few years ago by three professors at UCLA. According to this approach, the “interrelating agreements” among the participants in a business are little more than ad hoc arrangements: “[T]here are no firms,

230. See Blair & Stout, supra note 229, at 271-87.
231. See id. at 312.
232. Id.
233. See, e.g., Kerr McGee Corp., Schedule 13D (Mar. 3, 2005) (filed by Icahn) (start of proxy fight to elect directors who will sell assets and reallocate corporate resources to a stock buy-back).
235. Id. at 323.
no predetermined hierarchies, no organizations . . . and no a priori notions of ownership or control; there is no shareholder or managerial primacy and no centralizing ‘nexus.’”

In a word, “there is nothing to govern.” For a public shareholder, what inevitably ensues is a sort of virtually formless political free-for-all essentially devoid of theoretical principles. But this is not necessarily bad. “[I]nsurgency, contention, and debate are fundamental to effective corporate governance,” as John Pound once put it in the conclusion to his aptly titled article The Rise of the Political Model of Corporate Governance and Corporate Control.

This is really little more than the raw balance-of-power politics familiar to any historian of eighteenth century Europe. According to one classic text, statesmen of that era confronted “an anarchic . . . society in which expansion was left free until it was checked by conflicting ambitions, expressed in terms of the balance of power.” This principle, in turn, was found more useful than international law, which was then “nothing more than a war code.” Translated into the language of hedge fund activism, this means that proxy fights and the threat of proxy fights operate far more efficiently to exercise control over directors than the purely legal alternatives—occasionally ephemeral fiduciary-duty legal principles and the vagaries of the market for corporate control.

Reliance on fiduciary-duty principles is misplaced because they are so limited. Duty of loyalty compliance usually requires little more than honesty in fact and a high tolerance for putting up with independent-committee board procedures. Duty of care compliance requires even less. Ordinary workaday director decisions are almost always protected by the business judgment rule, which amounts to a standard of gross negligence. The courts accordingly hardly second-guess any director decisions at all. Reliance on the disciplining effect of takeovers is equally misplaced. Apart from regulatory problems and a host of other issues including sheer size, legal devices such as staggered boards and poison pills can make many companies practically takeover-proof. Like international law in the eighteenth century, fiduciary-duty principles and

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237. Id. at 887.
238. Id.
240. See infra notes 255-57 and accompanying text.
241. See, e.g., In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 52-62 (Del. 2006) (holding that the board was not grossly negligent in firing the CEO); Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (leading case applying the gross negligence standard).
243. See Lucian A. Bebchuk et al., The Powerful Antitakeover Force of Staggered Boards: Theory Evidence, and Policy, 54 STAN. L. REV. 887, 914, 928 (2002) (finding that no hostile takeover “in recent memory” has ever succeeded against a company with both a poison pill and a staggered board of directors); Holman W. Jenkins, Jr., Don’t Sweat It: There’s Nothing Wrong with Corporate Governance That the Threat of
the supposedly disciplining effect of takeovers appear less than completely satisfactory as instruments of shareholder defense and control.

Yet another paradox lurks here. As noted in the Introduction, many in the corporate community believe that the corporate governance status quo remains fundamentally sound.247 According to Martin Lipton and Steven Rosenblum, the present system “has developed over many years . . . through an ongoing process of experimentation and experience,” and already makes “running an election contest through separate proxy materials . . . a viable alternative.”248 Gilchrest Sparks, a dean of the Delaware corporate bar, has similarly observed that the current director-centered system appears “robust,” and that the possibility of running a stand-alone proxy contest against an incumbent board is “becoming more rather than less real,” thanks in part to “the dramatic increase in focused capital available in the hands of hedge funds.”249 This self-satisfied rhetoric is not altogether empty. Hedge funds are rarely mistaken for status quo apologists, but (paradoxically) this is evidently what they believe, too, or else they would not act the way they do. In the hands of a well-financed activist such as a hedge fund, proxy fights make a viable and useful corporate governance tool.

At least in Delaware, takeover defenses generally do not work against proxy fights.250 For a hedge fund activist, an actual or threatened proxy fight is therefore direct, efficient, and as ultimately determinative as one of Napoleon’s battles. Beyond this, theory really does not enter much into it.

C. Activist Hedge Funds With Board Representation

Of course the entire approach changes if an activist fund succeeds in gaining direct board representation, thus joining the “team.” At this point, the rules of the game shift, sometimes for the worse. This is especially true when a fund achieves only minority board representation, such as when a company’s board is staggered so that all directors are not up for election every year, when the tactical choice is made to run a short slate or when a negotiated settlement is only partially successful.

No matter what the situation, the federal securities laws effectively mandate that any hedge fund with direct board representation become a long-term investor. Such a fund will likely be considered a presumptive “affiliate” sharing in company control, and consequently will not be able to sell shares freely in the market until some indeterminate time after the board relationship ends.251 If the fund communicates with its board

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247. See supra notes 15-16 and accompanying text.
248. Lipton & Rosenblum, supra note 15, at 69, 93.
249. Sparks, supra note 15, at 22. Vice Chancellor Strine also appears to believe in the “balance” between director and shareholder power in the current “American—that is, the Delaware—approach to corporation law.” Strine, supra note 15, at 1762-67.
250. See supra notes 83-87 and accompanying text. Of course, an effective staggered board will prevent a dissident from acquiring a majority of board seats in any single election, and an advance-notice bylaw will constrain a dissident’s timing.
251. See J. WILLIAM HICKS, SECURITIES LAW HANDBOOK SERIES: RESALE OF RESTRICTED SECURITIES 127-37 (2007) (discussing “affiliate” status of directors and those who appoint them); Robert A. Barron,
representatives or anyone else at the company about company affairs, as will often be the case, it will probably also find itself precluded from selling or buying any shares because of the insider trading rules.\textsuperscript{252} Depending upon the circumstances, there may even be the theoretical or real possibility of short-swing profits disgorgement under section 16 of the Securities Exchange Act.\textsuperscript{253} All these rules effectively combine to preclude short-term trading once one or more board seats are obtained.

State laws concerning director fiduciary duties further constrain an activist fund. Once on the board, even dissident directors elected after a proxy fight owe their fiduciary obligations to the company as a whole and to all its shareholders, not just to the activist that nominated them.\textsuperscript{254} The fiduciary obligation of loyalty, in particular, cannot be limited or disclaimed, and effectively makes financial hanky-panky with the company impossible, or at least subject to the exacting “entire fairness” standard of judicial scrutiny.\textsuperscript{255} This rule can make even otherwise ordinary dealings substantively subject to judicial second-guessing and procedurally difficult to accomplish without cumbersome “independent committee” review and approval.\textsuperscript{256} The SEC’s rules specifically mandating the disclosure of these kinds of “related party” transactions exacerbate matters by casting perhaps unwanted sunlight into these otherwise dark corners, and recently adopted rules now require disclosure of the company’s transaction approval procedures as well.\textsuperscript{257} Careful advance planning and detailed consultations with lawyers experienced

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\textsuperscript{253} See supra text accompanying notes 169-170; \textit{Romeo & Dye, supra} note 169, § 2.04 (discussing the “deputization” theory pursuant to which an entity that has a board representative can sometimes itself become subject to the Section 16 profits-disgorgement rule).

\textsuperscript{254} See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 708-11 (Del. 1983) (holding that directors’ fiduciary duties remain undiluted despite their appointment by majority stockholder); I. R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, \textit{THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS} § 4.38[B] (3d ed. 2006) (describing the “Responsibilities of Directors Designated by Majority or Other Large Stockholders”). Roberta Karmel has suggested that nominating shareholders should also have fiduciary duties. Roberta S. Karmel, \textit{Should a Duty to the Corporation Be Imposed on Institutional Shareholders?}, 60 BUS. LAW. 1 (2004).

\textsuperscript{255} See Kahn v. Lynch Commc’n Sys. Inc., 638 A.2d 1110 (Del. 1994) (holding that independent committee approval shifts the burden of showing entire fairness to the plaintiff). If a shareholder is not considered a “controlling” shareholder under Delaware law, the situation improves somewhat. Full disclosure and approval by the disinterested directors can preserve the protection of the business judgment rule and avoid “entire fairness” review. See DEL. CODE ANN. tit. 8, § 144 (2001); see generally 1 DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, \textit{THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS} 263-74, 402-31 (5th ed. 1998 & Supp. 2002).

\textsuperscript{256} See supra note 255.

\textsuperscript{257} See Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, 71 Fed. Reg. 53,158, 53,197-208 (Sept. 8, 2006) (amending disclosure requirements for transactions with related parties, including 5% shareholders, and adding disclosure requirement for related-party transaction approval procedures, currently and to be codified at 17 C.F.R. § 229.404, which is implemented in proxy solicitations
with these kinds of issues slow decision-making at every turn.

It logically follows that a dissident director’s fiduciary duties extend to any information received as a director, and that all this information must be kept confidential and not misused. In the words of the leading Delaware case, if the director “violates that duty, the law provides a remedy.” Sometimes corporations even manage to extract an explicit promise that a dissident board member simply will not share anything he learns with his sponsoring fund. Monitoring an investment under these kinds of informational constraints can frequently wind up being neither easy nor even particularly efficient or effective.

If a fund has won only minority representation, the problems deepen. The very structure of the board itself can work against the dissident faction. Boards act collegially. Indeed, “[c]ommon sense tells us that the constantly carping critic . . . is unlikely to be effective in persuading any group to effective collective action.” The dissidents can find themselves ostracized and left out of caucuses where all the real decisions are taken or, in truly extreme cases, excluded from a newly-formed executive committee with de facto plenary authority to run the company without any dissident input at all. Alternatively, a weak-willed dissident may succumb to cooption or outright capture. Sometimes, too, a dissident board faction can simply find itself outvoted.

through Item 7 of Schedule 14A, 17 C.F.R. § 240.101, Item 7 (2006)).


259. See Lee Hawkins, Jr & Joseph B. White, Kerkorian Aide to Join GM’s Board, WALL ST. J., Feb. 7, 2006, at A3 (describing the confidentiality agreement signed by Kerkorian’s board representative). Boards sometimes also adopt “gag” resolutions prohibiting the sharing of information with outsiders. See General Housewares Corp., Current Report (Form 8-K) (May 28, 1999) (resigning director setting forth text of board resolution prohibiting communications with “family, friends or business associates” or company advisers outside the presence of senior management). Because this kind of resolution could interfere with a director’s exercise of his fiduciary duties, there may be circumstances where it might not survive judicial challenge.


262. See Julie Connelly, Dissenting Directors: Should You Shut Up, Quit, or Fight?, CORP. BOARD MEMBER, Sept.-Oct. 2002, at 26 (noting that dissenters are “isolated so that you’re kept out of the information loop,” and describing the formation of a board executive committee excluding dissident); Phyllis Plicht, Breaking the Code of Silence, WALL ST. J., Apr. 10, 2006, at R4 (describing pressure to conform “at all costs” and what happens to those who do not).

263. See Arnoud W.A. Boot & Jonathan R. Macey, Monitoring Corporate Performance: The Role of Objectivity, Proximity and Adaptability in Corporate Governance, 89 CORNELL L. REV. 356, 358-59 (2004) (arguing that the “proximity” of board participation makes “capture” all but inevitable, and defining “capture” as when a “block shareholder . . . [who is] the ostensible monitor adopts the perspective of the management team [being] supervis[ed]”); Dent, supra note 174, at 909 (observing that “minority directors usually wind up indistinguishable from the majority”).

264. See Dennis K. Berman & Sarah Ellison, Tribune Buyback Drives Opposition From Chandlers, WALL ST. J., June 7, 2006, at A1 (three of 11 directors publicly become dissidents and are outvoted when company goes forward with planned self-tender); Monica Langley et al., GM Tensions Erupt As Kerkorian Ally Quits As Director, WALL ST. J., Oct. 7, 2006, at A1 (dissident loses vote and resigns).
One of the funds in the survey went so far as to refuse a proffered board seat because it did not see how “[a]s one vote among twelve” it would have “any greater ability to effect change.”

The actual experiences of many dissident directors, however, paint a picture not nearly so bleak. Even one dissident can often be highly effective, especially when it comes to killing unwanted mergers or other initiatives. After settling for just one board seat in his fight with Sovereign Bank, for example, Ralph Whitworth told the Wall Street Journal’s “Heard on the Street” column that “[v]ocal dissenter[s] . . . can have outsized influences in clubby corporate boardrooms, essentially exercising veto power over major strategic decisions such as an acquisition.” Sometimes the right dissident can wind up assuming board leadership: according to Carl Icahn, if you lobby carefully “eventually [they] see it your way . . . . It’s human nature. You talk to people. Board members start seeing the other side.” Having a big stake does not hurt either, and in the right hands can turn into a big stick. In fact, one theoretical study has concluded that truly independent directors such as those “who own a large block of shares or are employed by a large shareholder” may actually increase the effectiveness of a board because they are thereby “shielded from . . . ejection” and the consequent need to accede to management’s wishes.

This brings us to the strangest problem. At least some experienced directors and judges believe that when it comes to board service it helps to have “skin in the game.” If recent scandals such as those involving Enron, Tyco, and WorldCom have taught us that “being willing to challenge company management may be the most crucial qualification for a board seat,” and if having a lot of shares helps foster this kind of independence, then why do the SEC’s implementing rules under Sarbanes-Oxley discriminate against board representatives of 10% and larger shareholders?

But despite these problems, many activist hedge funds continue to seek board seats.

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266. David Enrich, Sovereign, Relational Crusaded Right up to Their Uneasy Trace, WALL ST. J., Mar. 24, 2006, at C3.
268. See Connelly, supra note 262 (stating that large share ownership means “persuasive muscle” in the boardroom).
269. Vincent A. Warther, Board Effectiveness and Board Dissent: A Model of the Board’s Relationship to Management and Shareholders, 4 J. CORP. FIN. 53, 65 (1998). Since only the stockholders (not the directors) can remove a director, an “ejected” board member is presumably ostracized, asked to resign, or not renominated. See DEL. CODE ANN. tit. 8, § 144(k) (2001).
270. See Strine, supra note 15, at 1781 (opining that stockholders with “skin in the game” should choose director nominees); Pritch, supra note 262, at R4 (quoting a dissident director as saying, “[n]o amount of consultants’ reports or peer review studies can substitute for directors who have skin in the game”).
272. See supra text accompanying notes 88-91; see also Eric M. Fogel & Andrew M. Geier, Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors, 32 DEL. J. CORP. L. 33, 72 (2007) (concluding that “we must reintroduce the common sense notion that owners should be legally and socially encouraged to supervise their own companies”).
Unlike some of the larger institutional investors, such as on occasion those associated with governmental entities and unions, they are in business exclusively to make money all the time. They therefore presumably believe that they will make more money with board representation, even minority representation, than without. Otherwise, they would not be activists who seek board seats. In theoretical terms, they consequently believe that vertical (meaning corporate officers) and horizontal (meaning the other directors) monitoring and control must be more efficient and effective from within than from without.\(^{273}\) And to hear the howls of protest from corporate managements and their lawyers reviewed in the Introduction,\(^{274}\) they are not the only ones to think so.

VI. CONCLUSION

At the end, we are inevitably left with a fundamental question: what is the meaning of hedge fund activism? This Article has conducted a legal, empirical, and theoretical study in an effort to develop an answer.

This Article has shown that the SEC opened the door to hedge fund activism when it got out of the proxy material pre-screening and censorship business in 1992 and when it adopted the Regulation MA-related “free communication” Rule 14a-12 in 1999. The recent rise in hedge fund assets, the increasing difficulties fund managers have had in finding ready-made investment opportunities for so much money, and the changes in investor and corporate attitudes following the scandals that led to the passage of the Sarbanes-Oxley Act in 2002 have all combined to allow hedge funds to walk through this open door.

This Article’s empirical survey of hedge fund activism during 2005 and the 2006 proxy season is notable both for what it found and for what it did not find. In raw numbers, 52 hedge fund activism situations during this period hardly make hedge funds a direct and present threat to corporate America. But the indirect effects appear to be much greater. Armed with Rule 14a-12 and evidently undeterred by the threat of becoming a “group” under the Schedule 13D rules, hedge funds with significant shareholdings have been able to use wolf-pack tactics against companies to achieve at least some of their aims. The ovine willingness of institutional investors to follow the pro-shareholder, pro-activist recommendations of ISS and its competitors have helped make these tactics still more effective.

Despite claims that hedge funds are frequently dangerously conflicted, the survey did not find much in the way of a “dark side” to hedge fund activism. With only one notable exception (Perry at Mylan Labs), adverse positions and other conflicts appear to have been fully disclosed in the few instances where they have appeared. Shareholders would seem to have been really put off by the disclosed conflicts only once (Verizon-MCI-Deephaven). Nevertheless, based on the survey, it seems that the proxy and Schedule 13D rules require clarification so that their line-item disclosure requirements directly pick up these potential conflicts.

In any event, what hedge funds actually do does not fit neatly into the “nexus of contracts” and other theories of how shareholders and corporate managements relate to


\(^{274}\) See supra notes 1-5 and accompanying text.
each other. At least one thing is clear. This Article would not exist if hedge funds were the powerless, atomized shareholders of the latter-day Berle and Means theorists or if they were deterred by the well-documented obstacles to a greater shareholder role in corporate governance.

Hedge fund activists paradoxically practice “shareholder primacy” but cannot believe in it as a theory lest it empower the large and frequently conflicted institutional investors such as public pension and union funds sufficiently to allow them to take a competing seat at the corporate governance table. There is also a second paradox. Hedge fund activists must believe in director primacy as an academic theory because it most accurately describes the current state of the real world and because it helps justify keeping these kinds of other institutions as far away from the corporate governance banquet table as possible. But of course as shareholder activists, they do not for a minute believe in “director primacy” as a practical matter. Perhaps the best way of thinking about how hedge fund activists fit into corporate governance today is raw balance-of-power politics with proxy fights taking the place of warfare. Or to phrase it another way, hedge fund activists appear to have finally effected what John Pound perhaps prematurely predicted over a decade ago: the rise of the political model of corporate governance.

Hedge fund activists apparently continue to believe that direct board representation helps them to achieve greater control over their investments and, presumably, greater profits. On the other side, corporate managements seem to believe that this kind of effective “control” is not at all an unalloyed good.

It is too early to say whether hedge fund activism is profitable for the funds, value-maximizing for other public shareholders, or good for corporate governance in the United States generally. As for the first point, the results so far appear somewhat mixed. As for the second, the survey uncovered substantial shareholder skepticism in just one instance. And as for the third, only time will tell. This Article’s data are too limited for a definitive answer. But this much seems certain: hedge fund activists do sometimes come up with “eminently sensible ideas,” and the pressure they bring is forcing managements far beyond those of the few specific companies directly affected to come up with their own good ideas or, in Martin Lipton’s words, to “[r]eview basic strategy . . . in light of possible arguments for spinoffs, share buybacks, special dividends, sale of the

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277. For an interesting early effort to answer precisely this question, see William W. Bratton, Hedge Funds and Corporate Governance Targets, 95 GEO. L.J. (forthcoming 2007).

278. Der Hovanesian, supra note 3, at 72.
Hedge fund activists are not “normal” institutional investors. They threaten and even actually launch proxy fights for corporate control. They attack in wolf packs. If this causes managements to reexamine their businesses and “review basic strategy” accordingly, corporate governance has unquestionably been improved.

279. Lipton, supra note 182, at 3.
APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

<table>
<thead>
<tr>
<th>Company</th>
<th>Insurgent</th>
<th>End Date</th>
<th>Principal Issues</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Steven Madden</td>
<td>Barrington Capital</td>
<td>2/2/05</td>
<td>Board seats, governance, sale</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td>Circuit City</td>
<td>Highfields Capital</td>
<td>3/7/05</td>
<td>Purchase offer</td>
<td>13D</td>
</tr>
<tr>
<td>Sears</td>
<td>Lampert</td>
<td>3/25/05</td>
<td>Negotiated sale</td>
<td>Stealth 13G</td>
</tr>
<tr>
<td>Beverly Enterprises</td>
<td>Appaloosa, Formation</td>
<td>4/11/05</td>
<td>Board seats, sale</td>
<td>13D, 14a-12, mailed</td>
</tr>
<tr>
<td>Kerr-McGee</td>
<td>Icahn</td>
<td>4/14/05</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, HSR</td>
</tr>
<tr>
<td>Blockbuster</td>
<td>Icahn</td>
<td>5/11/05</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>Cornell Companies</td>
<td>Private Capital</td>
<td>5/19/05</td>
<td>Board seats, sale, enhance value</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td>BioMarin Pharmaceuticals</td>
<td>OrbiMed Advisors</td>
<td>5/27/05</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, mailed, short-slate rule</td>
</tr>
</tbody>
</table>
## Appendix: Hedge Fund Activism, January 2005 – August 2006

<table>
<thead>
<tr>
<th>Amount Held</th>
<th>Litigation</th>
<th>Result</th>
<th>ISS Advice</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.7%</td>
<td></td>
<td>1 independent board seat, stock buy back</td>
<td></td>
<td>Settled</td>
</tr>
<tr>
<td>6.8%</td>
<td></td>
<td>Offer rejected, stock buy back</td>
<td></td>
<td>CEO later resigned</td>
</tr>
<tr>
<td>15.0%</td>
<td>Late 13D (post hoc by holder)</td>
<td>Sale to K-Mart</td>
<td>For merger</td>
<td>Lampert owned 52% of K-Mart</td>
</tr>
<tr>
<td>8.1%</td>
<td></td>
<td>Sale, no board seats</td>
<td></td>
<td>Settled; used wolf pack tactics</td>
</tr>
<tr>
<td>7.6%</td>
<td>13D, proxy rules</td>
<td>Buy back, asset sale, no board seat</td>
<td></td>
<td>Settled; company sold in 2006</td>
</tr>
<tr>
<td>9.7%</td>
<td></td>
<td>3/7 board seats won</td>
<td>Dissidents (2/3)</td>
<td>Board expanded by 1 to put CEO back on board</td>
</tr>
<tr>
<td>14.8% + 5% + 7.5%</td>
<td></td>
<td>7/9 board seats</td>
<td></td>
<td>Settled; top 9 holders held 75.7%</td>
</tr>
<tr>
<td>8.2%</td>
<td></td>
<td>2 board seats + 1 independent</td>
<td></td>
<td>Settled</td>
</tr>
</tbody>
</table>
### APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

<table>
<thead>
<tr>
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<th>End Date</th>
<th>Principal Issues</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>BKF Capital Group</td>
<td>Steel Partners</td>
<td>6/9/05</td>
<td>Board seats, governance</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>Mylan Labs</td>
<td>Icahn</td>
<td>7/18/05</td>
<td>Board seats, oppose merger, Icahn offer letter</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td>AirNet Systems</td>
<td>Opportunity, Pacific Coast</td>
<td>7/27/05</td>
<td>Board seats, sale</td>
<td>13D, special meeting consent solicitation</td>
</tr>
<tr>
<td>Cutter &amp; Buck</td>
<td>Private Capital</td>
<td>9/7/05</td>
<td>Board seats, governance</td>
<td>13D</td>
</tr>
<tr>
<td>Siebel Systems</td>
<td>Tudor, Jana, Icahn</td>
<td>9/12/05</td>
<td>Sale</td>
<td>13G, Publicity</td>
</tr>
<tr>
<td>Cenveo</td>
<td>Burton Capital</td>
<td>9/13/05</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, mailed</td>
</tr>
<tr>
<td>Register.com</td>
<td>Barrington Capital and Mark Cuban</td>
<td>9/15/05</td>
<td>Board seats, sale price</td>
<td>13D, 14a-12</td>
</tr>
</tbody>
</table>
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<th>ISS Advice</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.5%</td>
<td>3 board seats won, destaggered board</td>
<td>Dissidents</td>
<td>Significant economic loss</td>
<td></td>
</tr>
<tr>
<td>9.8%</td>
<td>Legality of bylaws, by Icahn</td>
<td>Offer and proxy fight dropped, issuer self-tender</td>
<td></td>
<td>Short in merger counterparty; vote buying</td>
</tr>
<tr>
<td>13.3%</td>
<td>2 board seats, sale efforts</td>
<td>Settled; delisted from NYSE after sale efforts falter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12.5%</td>
<td>Terminated pill, declassified board, no seats</td>
<td>Settled; top 5 holders had 51%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.7% + 10% misc. others</td>
<td>Sale</td>
<td></td>
<td>“Heard on the Street” in WSJ</td>
<td></td>
</tr>
<tr>
<td>10.7%</td>
<td>7/9 board seats</td>
<td>Dissidents</td>
<td>Settled; called special meeting (had over 10%)</td>
<td></td>
</tr>
<tr>
<td>14.9% + 13.7%</td>
<td>$500k, Barrington joined buyer; Cuban objects</td>
<td></td>
<td>Settled; joint slate without “group” filing</td>
<td></td>
</tr>
</tbody>
</table>
## APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

<table>
<thead>
<tr>
<th>Company</th>
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<th>End Date</th>
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<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shopko</td>
<td>John A. Levin &amp; Co.</td>
<td>9/29/05</td>
<td>Sale price</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td>MCI</td>
<td>Deephaven</td>
<td>10/06/05</td>
<td>Sale price</td>
<td>Proxy statement only, started mailing</td>
</tr>
<tr>
<td>Computer Horizons</td>
<td>Crescendo</td>
<td>10/11/05</td>
<td>Board seats, oppose merger, sale</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>Alliance Semi-Condctor</td>
<td>B. Riley &amp; Co.</td>
<td>10/18/05</td>
<td>Board seats, asset sales</td>
<td>13D, 14a-12, mailed</td>
</tr>
<tr>
<td>A. Schulman</td>
<td>Barrington</td>
<td>10/24/05</td>
<td>Board seats, sale</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td>Exar</td>
<td>GWA Investments</td>
<td>11/07/05</td>
<td>Board seats, governance, enhance value</td>
<td>14a-12, full contest</td>
</tr>
<tr>
<td>Knight Ridder</td>
<td>Private Capital</td>
<td>11/14/05</td>
<td>Sale</td>
<td>13D</td>
</tr>
<tr>
<td>Six Flags</td>
<td>Red Zone</td>
<td>11/22/05</td>
<td>Board seats, governance, sale</td>
<td>13D, 14a-12 full consent solicitation</td>
</tr>
</tbody>
</table>
## APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

<table>
<thead>
<tr>
<th>Amount Held</th>
<th>Litigation</th>
<th>Result</th>
<th>ISS Advice</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.0%</td>
<td></td>
<td>$300k, voting agreement, higher price</td>
<td></td>
<td>Settled; interloper wins company</td>
</tr>
<tr>
<td>4.9%</td>
<td></td>
<td>Lost vote but got higher price</td>
<td>For merger</td>
<td>Owned bonds, stock, swaps, short in others</td>
</tr>
<tr>
<td>10.3%</td>
<td>Not significant</td>
<td>5/5 board seats won, merger defeated</td>
<td>Management slate, but oppose merger</td>
<td>Bylaws permitted 10% meeting call</td>
</tr>
<tr>
<td>6.9%</td>
<td></td>
<td>4/7 board seats</td>
<td>Dissidents (1/5)</td>
<td>Settled</td>
</tr>
<tr>
<td>8.7%</td>
<td></td>
<td>Self tender, 1 board seat + 1 independent</td>
<td></td>
<td>Settled</td>
</tr>
<tr>
<td>0.7%</td>
<td></td>
<td>3/9 board seats won</td>
<td>Dissidents</td>
<td>Independence listing problems after win; GWA was 96% hedged</td>
</tr>
<tr>
<td>18.9% + 9% + 8%</td>
<td></td>
<td>Sale</td>
<td></td>
<td>Proxy fight threatened</td>
</tr>
<tr>
<td>11.7%</td>
<td></td>
<td>3/7 board seats won, de facto control</td>
<td>Dissidents</td>
<td>Charter allowed consent; sale process fizzles</td>
</tr>
</tbody>
</table>
APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

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<tr>
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<tbody>
<tr>
<td>Ligand Pharmaceuticals</td>
<td>Third Point</td>
<td>12/5/05</td>
<td>Board seats, maximize value</td>
<td>13D, 14a-12, preliminary proxy</td>
</tr>
<tr>
<td>Office Max</td>
<td>K Capital Partners</td>
<td>4/27/05 and 12/27/05</td>
<td>Sale, governance, board seat</td>
<td>13D, 14a-12, started mailing</td>
</tr>
<tr>
<td>McDonald’s</td>
<td>Pershing Square</td>
<td>1/24/06</td>
<td>Enhance value</td>
<td>Publicity</td>
</tr>
<tr>
<td>Bally Total Fitness</td>
<td>Pardus; Liberation</td>
<td>1/26/06</td>
<td>Board seats, governance, enhance value</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>General Motors</td>
<td>Tracinda</td>
<td>2/6/06</td>
<td>Board seat, Enhance value</td>
<td>13D, HSR</td>
</tr>
<tr>
<td>Phelps Dodge</td>
<td>Atticus</td>
<td>2/15/06</td>
<td>Maximize value</td>
<td>13D</td>
</tr>
<tr>
<td>Time Warner</td>
<td>Icahn</td>
<td>2/17/06</td>
<td>Board seats, maximize value</td>
<td>13D, 14a-12 (13D filed by Icahn advisee)</td>
</tr>
</tbody>
</table>
### APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>9.9%</td>
<td>Late annual meeting, by Third Point</td>
<td>3/11 board seats; maximize value</td>
<td>Settled; top 9 holders had 63%</td>
<td></td>
</tr>
<tr>
<td>6.2%; then 8.6%</td>
<td>1 independent board seat, de-staggered board</td>
<td>1st year settled; 2nd year unilateral exit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.9%</td>
<td>Many restaurants to be sold</td>
<td>Low risk, modest success</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14.3% + 12% + 10%</td>
<td>Pill and 13D, state and federal court</td>
<td>3/9 board seats won; company was shopped; CEO fired</td>
<td>Dissident slate Joint slate with no group filing or Pill trigger; owned debt; 3-way fight</td>
<td></td>
</tr>
<tr>
<td>9.9%</td>
<td>1 board seat, dividend cut</td>
<td>Settled; big 13D publicity campaign</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.9%</td>
<td>None</td>
<td>Refused board seat</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.7%</td>
<td>2 independent directors, larger stock buy-back</td>
<td>Settled; 14a-12 war w/o proxy statement; derivatives issues</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006**

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<tr>
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</thead>
<tbody>
<tr>
<td>Wendy's</td>
<td>Trian Fund</td>
<td>3/3/06</td>
<td>Board seats, enhance value</td>
<td>13D</td>
</tr>
<tr>
<td>Novoste</td>
<td>Steel Partners</td>
<td>3/21/06</td>
<td>Board seats, oppose liquidation</td>
<td>13D, full contest on liquidation vote; then preliminary proxy</td>
</tr>
<tr>
<td>Sovereign Bank</td>
<td>Relational Investors</td>
<td>3/28/06</td>
<td>Board seats, governance, oppose merger</td>
<td>13D, 14a-12, prelim. proxy filed early</td>
</tr>
<tr>
<td>Gencorp</td>
<td>Pirate Capital, Gamco</td>
<td>3/31/06</td>
<td>Board seats, governance, maximize value</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>Chiron</td>
<td>Value Act, CAM North American</td>
<td>4/03/06</td>
<td>Sale price</td>
<td>13D</td>
</tr>
<tr>
<td>Synergy Financial Group</td>
<td>PL Capital</td>
<td>4/04/06</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, short slate rule, full contest</td>
</tr>
<tr>
<td>Reliant Energy</td>
<td>Seneca Capital</td>
<td>4/18/06</td>
<td>Board seats</td>
<td>Publicity</td>
</tr>
</tbody>
</table>
### Appendix: Hedge Fund Activism, January 2005 – August 2006

<table>
<thead>
<tr>
<th>Amount Held</th>
<th>Litigation</th>
<th>Result</th>
<th>ISS Advice</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.5% + 22% misc. others</td>
<td></td>
<td>3/15 board seats</td>
<td></td>
<td>Settled; white paper; wolf pack tactics; options</td>
</tr>
<tr>
<td>19.6% + 5.3% + 8.2%</td>
<td>Liquidation defeated; 3/4 seats</td>
<td>Against liquidation; silent on board contest</td>
<td></td>
<td>Board contest settled at preliminary proxy stage</td>
</tr>
<tr>
<td>8.4%</td>
<td>Extensive; Pennsylvania law also changed</td>
<td>1 board seat + 1 independent board seat</td>
<td></td>
<td>Settled; 14a-12 war with newspaper ads</td>
</tr>
<tr>
<td>8.4% + 9.9%</td>
<td>Suit to avoid Ohio anti-takeover law, by dissident</td>
<td>3/10 board seats won</td>
<td>Dissidents (1/3)</td>
<td>Top 7 holders had 48%</td>
</tr>
<tr>
<td>5.2% + 11.5%</td>
<td></td>
<td>$45 offer raised to $48</td>
<td>ISS also said $45 was low</td>
<td>Good result for minimal effort</td>
</tr>
<tr>
<td>9.8%</td>
<td></td>
<td>2/3 board seats won (all sought)</td>
<td>Dissident</td>
<td>Full board was 9; CEO lost seat</td>
</tr>
<tr>
<td>4.0%</td>
<td></td>
<td>1 independent to be named by company</td>
<td></td>
<td>Settled; 14a-9 made company disclose campaign</td>
</tr>
</tbody>
</table>
### APPENDIX: HEDGE FUND ACTIVISM, JANUARY 2005 – AUGUST 2006

<table>
<thead>
<tr>
<th>Company</th>
<th>Insurgent</th>
<th>End Date</th>
<th>Principal Issues</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Star Gas</td>
<td>Third Point</td>
<td>3/8/05 and 4/28/06</td>
<td>Replace CEO; replace general partner</td>
<td>13D</td>
</tr>
<tr>
<td>Warwick Valley</td>
<td>Santa Monica</td>
<td>4/28/06</td>
<td>Board seats, maximize value</td>
<td>13D, full contest</td>
</tr>
<tr>
<td>Telephone</td>
<td>Partners</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yardville Bank</td>
<td>Seidman entities</td>
<td>5/3/06</td>
<td>Board seats, maximize value</td>
<td>13D, full contest</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Massey Energy</td>
<td>Third Point</td>
<td>5/16/06</td>
<td>Board seats, maximize value</td>
<td>13D, 14a-12, full contest</td>
</tr>
<tr>
<td>InfoUSA</td>
<td>Dolphin</td>
<td>5/26/06</td>
<td>Board seats, governance, maximize value</td>
<td>14a-12, full contest</td>
</tr>
<tr>
<td>Life Point</td>
<td>Accipter</td>
<td>5/30/06</td>
<td>Board seats</td>
<td>14a-12, mailed</td>
</tr>
<tr>
<td>Hospitals</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SCPIE Holdings</td>
<td>Stillwell</td>
<td>6/22/06</td>
<td>Board seats, enhance value</td>
<td>13D, 14a-12, full contest</td>
</tr>
</tbody>
</table>
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<tr>
<th>Amount Held</th>
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</tr>
</thead>
<tbody>
<tr>
<td>6.2% + 5.3% + 5.4%</td>
<td>CEO and General Partner replaced</td>
<td></td>
<td></td>
<td>Two seasons; two other hedge funds filed 13Gs</td>
</tr>
<tr>
<td>2.4%</td>
<td>Untimely nomination, by dissident</td>
<td>Lost vote</td>
<td></td>
<td>Hired banker for strategic alternatives afterwards</td>
</tr>
<tr>
<td>8.3%</td>
<td>Nominee qualification, by dissident</td>
<td>Lost vote</td>
<td>Management</td>
<td>Bylaw disqualified Seidman himself</td>
</tr>
<tr>
<td>5.9%</td>
<td>Post-hoc vote counting</td>
<td>Won both board seats sought</td>
<td>Dissidents (1/2)</td>
<td>Cumulative voting</td>
</tr>
<tr>
<td>3.6%</td>
<td>Books and records, by dissident</td>
<td>Lost vote (moral victory only)</td>
<td>Dissidents</td>
<td>CEO had 40%; use of books &amp; records “dirt”</td>
</tr>
<tr>
<td>1.8%</td>
<td>Untimely nomination, by dissident</td>
<td>Dropped</td>
<td></td>
<td>Nomination was too late</td>
</tr>
<tr>
<td>7.3%</td>
<td>Shareholder list, by dissident</td>
<td>Lost vote</td>
<td>Management</td>
<td>No insurance industry experience</td>
</tr>
</tbody>
</table>
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</tr>
</thead>
<tbody>
<tr>
<td>Houston Exploration</td>
<td>Jana</td>
<td>6/27/06</td>
<td>Purchase offer, maximize value</td>
<td>13D, notice of exempt solicitation</td>
</tr>
<tr>
<td>Ubiquitel</td>
<td>Deephaven</td>
<td>6/27/06</td>
<td>Board seats, sale price</td>
<td>13D, “full” contest (mailed 6/21/06)</td>
</tr>
<tr>
<td>Sunterra</td>
<td>CD Capital,</td>
<td>7/26/06</td>
<td>Sale, governance, board seat</td>
<td>13D</td>
</tr>
<tr>
<td></td>
<td>Chapman Capital,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third Point</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Topps</td>
<td>Pembridge,</td>
<td>6/13/05 and</td>
<td>Directors, governance, maximize value</td>
<td>13D, 14a-12, full contest settled on meeting day</td>
</tr>
<tr>
<td></td>
<td>Crescendo</td>
<td>7/28/06</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pep Boys</td>
<td>Barrington,</td>
<td>8/03/06</td>
<td>Board seats, sale</td>
<td>13D, 14a-12</td>
</tr>
<tr>
<td></td>
<td>Pirate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Axiom</td>
<td>ValueAct</td>
<td>10/27/05 and</td>
<td>Purchase offer; board seats, governance, enhance value</td>
<td>13D, 14a-12, Preliminary proxy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8/07/06</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heinz</td>
<td>Trian</td>
<td>8/16/06</td>
<td>Board seats, governance, enhance value</td>
<td>13D, 14a-12, short slate rule, full contest</td>
</tr>
<tr>
<td>ImClone Systems</td>
<td>Icahn</td>
<td>8/24/06</td>
<td>Board seats, enhance value</td>
<td>13D</td>
</tr>
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<tbody>
<tr>
<td>12.8%</td>
<td></td>
<td>Value efforts</td>
<td></td>
<td>Only “notice” filing in data base</td>
</tr>
<tr>
<td>17.9%</td>
<td></td>
<td>Lost all votes</td>
<td>Management</td>
<td>Only 6 days’ non-oral solicitation</td>
</tr>
<tr>
<td>6.8% + 8.4% + 9.8%</td>
<td></td>
<td>1 board seat, sale efforts</td>
<td></td>
<td>Delisted, CEO fired for cause, SEC investigation</td>
</tr>
<tr>
<td>7.4%</td>
<td></td>
<td>$50k, value efforts 1st year; 2nd year 3/10 board seats</td>
<td>Dissidents</td>
<td>1st year settled; 2nd year settled for all 3 seats sought</td>
</tr>
<tr>
<td>9.9% + 8.3%</td>
<td></td>
<td>$200k, 4/10 board seats</td>
<td></td>
<td>Settled, CEO quit, delayed meeting</td>
</tr>
<tr>
<td>10.4% ; then 11.9%</td>
<td></td>
<td>Offer rejected; 2/11 board seats, stock buy-back</td>
<td></td>
<td>Offer failed; then settled proxy contest</td>
</tr>
<tr>
<td>5.5%</td>
<td></td>
<td>2/12 board seats won + 2 independents</td>
<td>Dissidents (3/5)</td>
<td>Dueling contest web sites, much publicity</td>
</tr>
<tr>
<td>12.9%</td>
<td></td>
<td>4/9 board seats</td>
<td></td>
<td>Settled</td>
</tr>
</tbody>
</table>