

November 28, 2016

## 2016 U.S. Shareholder Activism Review and Analysis

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### **Activists Face Headwinds in 2016; Institutional Investors Highlight Risks of Settling Too Quickly and Without Consultation; Number of Campaigns Remains High, Reflecting More Campaigns by Newer and Less Frequent Activists**

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#### **EXECUTIVE SUMMARY**

Shareholder activism remains a major force in corporate decision-making in 2016 but is increasingly operating in an environment of robust, multi-faceted shareholder engagement, particularly at large companies. The time and effort that companies and institutional investors have spent developing a mutual understanding of each other's concerns have narrowed the opportunities for activists at high-profile companies, and the returns of activist funds overall are down in 2016. The total number of activist campaigns has nevertheless remained high, due in large part to newer and often smaller activists targeting small and mid-size companies.

Large institutional investors have long been an important constituency in any activist campaign, and the influence of these institutions has continued to grow, as share ownership becomes increasingly concentrated and as they directly express their views and concerns, both through direct engagement with companies and by public pronouncements of their priorities, including their skepticism over the impact of "short-termism" that activism can engender.

This publication summarizes significant developments in proxy contests and other activist campaigns in 2016, as compared to the preceding years, including the following:

- ***Index and Other Institutional Investors.*** Developments in the institutional investor space, including an increased concentration of ownership in a handful of large index funds and other institutions, as well as an increased focus by institutions on engagement and governance reform. The success of

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activist investors, and of companies in defending against activist campaigns, increasingly hinges on the receptivity of large institutional investors to their respective arguments.

- **Activist Investors.** Trends in the assets under management and performance of activist hedge funds as compared to the hedge fund industry generally (which is facing its own challenges), as well as activist fund formation, all of which highlight the fundraising and performance challenges experienced by many activists funds in 2016. This includes a discussion of the most prolific activists and those most successful in obtaining board seats. A notable development in 2016 is an increase in the number of activist demands made by investors beyond those that have dominated the activism space in recent years.
- **Target Companies.** Trends in activism targets by market cap and industry, including the decline in large companies as targets in the past two years. To a large extent, the willingness of activists to initiate campaigns at larger companies has helped to mitigate any stigma associated with being the target of an activist campaign, which can reduce the effectiveness of an activist's threat to take its demands public.
- **Types and Objectives of Activist Campaigns.** The frequency, objectives and outcomes of activist campaigns, including:
  - Frequency of different campaign types, including efforts to obtain board representation (via proxy contests or settlements)
  - Trends in the ultimate economic objectives of activist campaigns, including the greater focus on board-related governance issues in 2016 proxy contests, as compared to the traditional objectives of returning capital to shareholders or taking specified M&A actions
  - Tactics used in activist campaigns, including publicity campaigns and, less commonly, putting forth concurrent shareholder proposals
  - Actions taken by companies during activist campaigns, including substantive responses such as increased share repurchases (which have been less frequent in 2016), governance changes, and tactical actions (which are relatively rare at this point).
- **Proxy Contests.** Proxy contests, including:
  - Frequency in 2016 as compared to prior years
  - How many went to a vote, were withdrawn, or were settled
  - The number of seats sought, and relative frequency of short slates versus control slates
  - Full or partial success rates of contests
  - Trends in proxy advisor firms' recommendations
  - Governance, structural or management changes made after the conclusion of contests
- **Announced Settlements.** Recent trends in settlement agreements, including an increase in the frequency and speed of settlements, which is consistent with concerns raised by institutional investors that some companies may be settling too quickly and without broad consultation. This section also highlights common terms of settlement agreements, such as minimum holding levels, director pre-resignation, duration and scope of standstills, voting agreements, information sharing and expense reimbursement.
- **Potential Impact of SEC Universal Proxy Proposal.** The potential implications for shareholder activism of the SEC's recent proposal to require universal proxy cards, including the extent to which the ability of dissidents to include management nominees on their cards may give them an advantage in waging a low-cost proxy battle at companies with a concentrated shareholder base.

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- **Potential Impact of Proxy Access.** The relationship between proxy access and proxy contests, including limitations on the viability of proxy access as an alternative to proxy contests.<sup>1</sup> To date only one activist, GAMCO Asset Management, Inc., has made a proxy access nomination, though the company has rejected the nomination as non-compliant with its proxy access bylaw.
- **Steps Companies Should Take.** Certain steps that companies should consider to enhance preparedness for a potential activist situation, including:
  - Identifying possible activist arguments in light of the company's particular circumstances, and preparing responses
  - Preparing the board of directors on possible activist approaches, shareholder engagement efforts and developments in activist strategies
  - Engaging with institutional investors to advance mutual understanding on governance and strategic issues
  - Reviewing corporate bylaws in light of continuously developing market practices

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### NOTES ON THE SCOPE AND SOURCES OF DATA USED IN THIS PUBLICATION

The information in this publication on proxy contests and other activist campaigns is based on the database maintained by FactSet Research Systems, Inc. on SharkRepellent.net, using a data run on November 8, 2016, supplemented as necessary by our own review of public information and other third-party sources. In order to provide an analysis relevant to our U.S. public company clients, we have not included campaigns at companies with a market cap of under \$100 million and have not included campaigns at non-U.S. companies. We have followed the SharkRepellent categorization of campaigns as “proxy fights” or “other stockholder campaigns,” but have not included those categorized merely as exempt solicitations or Schedule 13D filings with no public activism. We have not included the mere submission of Rule 14a-8 proposals as “campaigns,” though the section “Types and Objectives of Activist Campaigns” discusses the use of shareholder proposals that were brought in conjunction with the activist campaigns covered in this publication. We have also excluded from the “other stockholder campaigns” category strategic acquisition attempts that involve unsolicited offers by one business entity to acquire another, though we have included takeover attempts involving unsolicited offers by private equity funds and other investors.

Data in this publication regarding hedge fund assets under management, performance and formation is based on the most recent Hedge Fund Industry Report issued by Hedge Fund Research (HFR), unless otherwise indicated. Other data sources, including CamberView Partners, Proxy Pulse (a Broadridge and PricewaterhouseCoopers initiative) and Preqin, are identified as they arise.

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<sup>1</sup> For a comprehensive discussion of proxy access, as well as public company governance, compensation and disclosure more generally, see the Public Company Deskbook: Complying with Federal Governance and Disclosure Requirements (Practising Law Institute) by our partners Bob Buckholz, Marc Trevino and Glen Schleyer, available at 1-800-260-4754 (1-212-824-5700 outside the United States) or <http://www.pli.edu>.

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## GENERAL OBSERVATIONS ON THE STATE OF SHAREHOLDER ACTIVISM

The past decade has seen a seismic shift in the relations between companies and their shareholders. In an earlier era, when communication between companies and shareholders was less frequent and more formal, activist demands for strategic, management or operational changes were viewed as hostile acts to be defended against. The widespread presence of certain governance features, such as staggered boards, plurality voting and shareholder rights plans (poison pills), made it easier for companies to do so.

The approach is different today for U.S. public companies, particularly larger ones. The most powerful antitakeover or anti-insurgent protections, as well as plurality voting, have become much less common, and shareholder engagement, spurred in part by mandatory say-on-pay, has become a matter of significant corporate focus.

The influence of large index and other institutional investors has been central to this change in tone and practice. Although these investors rarely, if ever, engage directly in activism, they do support activists in certain situations. Similarly, while rarely making governance proposals, they consistently supported the Rule 14a-8 proposals that led to the decrease in antitakeover defenses and the adoption of majority voting and proxy access among large-cap companies and have made strong public statements advancing their positions on a number of governance issues. The largest investors have conveyed to companies their desire to engage, while stressing that their voting decisions were a result of internal determinations, rather than simply following proxy advisory firms' recommendations.

These changes, which are themselves significantly attributable to campaigns by activists, have now resulted in an engagement environment that presents fewer opportunities for these same activists. Increased corporate engagement has made companies more aware than they were in the past of potential activist demands as well as actions that could resonate with their shareholder base more broadly. These more open lines of communication mean that institutional investors are less dependent on activists to serve as watchdogs for corporate efficiency, performance and governance. The ongoing engagement has relieved tensions and in certain cases addressed potential shareholder concerns before they became a catalyst for a successful activist campaign. In addition, the spread of activism among larger respected companies has largely removed the stigma of an activist campaign, reducing the effectiveness of an activist's threat to take its demands public.

Importantly, a number of the most prominent institutional investors have recently raised concerns over the possible adverse longer-term consequences of activists' short-termism—and corporate acquiescence to activist demands—and urged companies to consult with shareholders before acceding to an activist's demands. This highlights an important potential pendulum swing that may give companies an avenue to resist activist demands that the board believes are not in the company's long-term interests.

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As discussed further below, 2016 has seen a shift toward activist campaigns by newer and less well-known investors at smaller companies, where less investment is needed to gain traction, and where the boards and management may be less well prepared. It remains to be seen if the most prominent activists can regain traction at larger companies, or if activist campaigns will follow in the tracks of governance reforms and focus on opportunities at the next size tier of companies.

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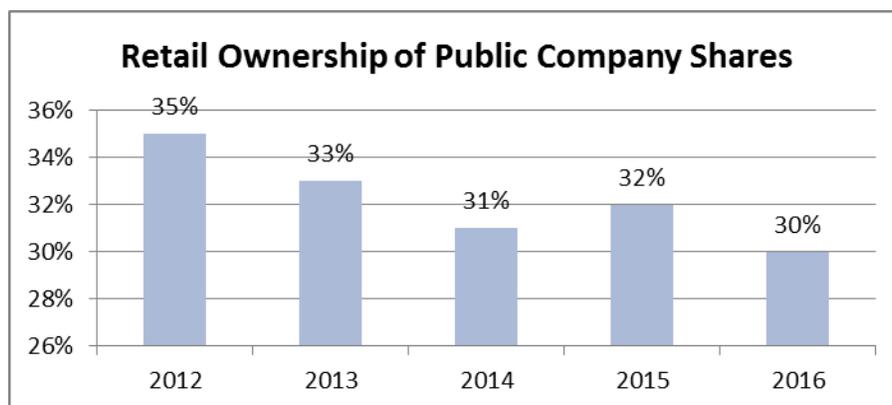
### INSTITUTIONAL INVESTORS

Before turning to a detailed discussion of activist campaigns, it is worth highlighting trends at the large institutional investors that affect the activism playing field. Despite the growth of activist investing in recent years, activists in aggregate hold a very small percentage of public company stock. Even in companies where they launch activist campaigns, activists usually do not hold enough stock to play a directly determinative role in vote outcomes—for campaigns launched in 2015, the median percentage ownership of the dissident group was less than 7%, and was less than 3% at companies with a market cap of over \$20 billion.

In order to succeed in proxy contests or other campaigns, activists depend on the support of the large institutional investors that have become increasingly dominant in the share ownership space. These large investors, particularly index funds who are unable to “vote with their feet” when it comes to corporate performance, management and structure, are well aware of their critical role, and this is reflected in their responses to and engagement with issuers and activists. In this section, we highlight some of the investment and governance trends that have increased the importance of these institutional investors.

#### A. SHIFT FROM RETAIL TO INSTITUTIONAL OWNERSHIP

More shares of public companies are in the hands of institutions than in the hands of retail investors. Although this has been the case for a long time, the trend away from retail ownership and toward institutional ownership has continued in recent years:<sup>2</sup>



<sup>2</sup> Source: [ProxyPulse](#), Broadridge and PricewaterhouseCoopers, 2016 Proxy Season Review and 2015 Proxy Season Wrap-up.

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This decline in retail ownership understates the actual increase in voting power held by institutional investors. From a shareholder activism standpoint, a critical difference between retail and institutional investors is their voting participation level. In 2016, only 28% of retail-held shares were voted, compared to 91% of shares held by institutions.<sup>3</sup> The diminishing voting power of retail shareholders has been amplified by the elimination of broker discretionary voting on uninstructed “street name” shares. Beginning in 2009, NYSE rules prohibited the voting of uninstructed shares in uncontested director elections.<sup>4</sup> In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibited discretionary voting on say-on-pay and other executive compensation matters. And in 2012, the NYSE changed its broker voting policies to prohibit discretionary broker voting on “good governance” changes, even though these generally increase, rather than limit, shareholder rights. While discretionary broker voting was prohibited in contested elections even before these changes, these new rules increased the influence of institutional investors on director “vote no” campaigns and on the types of governance changes that removed traditional antitakeover structures from companies, such as staggered boards and supermajority voting requirements. The use of notice-and-access for delivery of proxy materials to shareholders has also contributed to the declining voter participation of retail investors.<sup>5</sup>

### B. SHIFT TO INDEX INVESTING

Even within the institutional investor community, recent trends place greater emphasis on proxy voting matters. In particular, there has been a notable shift of investment dollars away from institutions with active investment philosophies toward index funds and other passive investors. The Wall Street Journal recently noted that as of mid-2016, U.S.-based mutual funds and exchange-traded funds that track indexes owned 11.6% of the S&P 500, up from 4.6% in 2006. These index funds now comprise nearly 30% of all mutual funds and ETFs. In addition, as of June 2016, 112 S&P 500 companies had more shares held by passive mutual funds and ETFs than by active ones, compared to 12 in 2015.<sup>6</sup>

Unlike active investors, index funds are not discretionary shareholders; they are unable to react to performance, management or governance concerns by selling shares and moving funds to more preferable companies. Instead, they are dependent on engagement with companies to advance desirable changes, and on their use of voting power, whether in response to management proposals, shareholder proposals or activist campaigns, to encourage these changes.

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<sup>3</sup> [ProxyPulse](#), 2016 Proxy Season Review. This relates to overall votes; not merely contested matters.

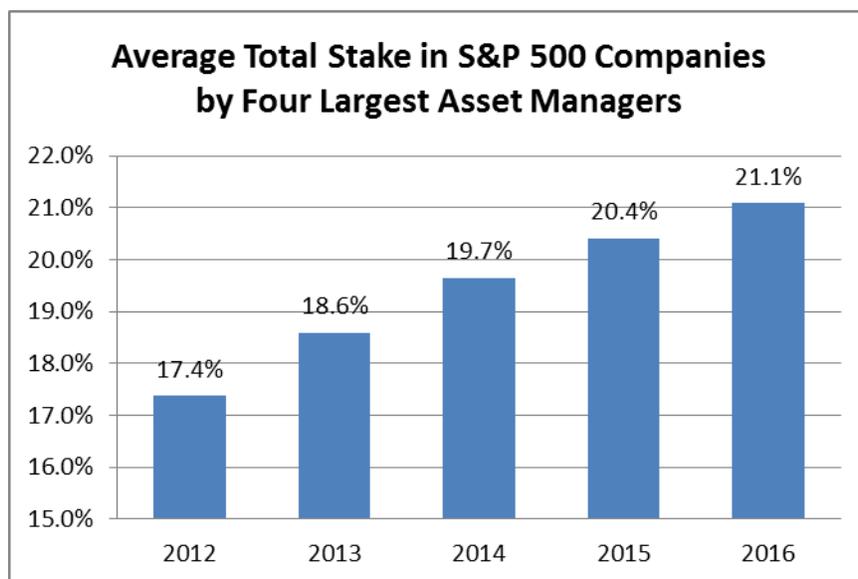
<sup>4</sup> See [SEC Release No. 34-60215](#) (July 1, 2009) approving changes to NYSE Rule 452 and Listed Company Manual Section 402.08.

<sup>5</sup> The concerns over reduced retail participation when notice-and-access is used are discussed in [SEC Release No. 33-9108](#) (Feb. 22, 2010).

<sup>6</sup> Wall Street Journal, *Passive Funds Embrace Their New Power* (Oct. 25, 2016) and *The Passivists: The Case for the Triumph of Passive* (Oct. 19, 2016)

### C. CONCENTRATION AMONG LARGEST INSTITUTIONAL INVESTORS

The influence of institutional investors on proxy voting, as enhanced by the trends described above, has become further concentrated in the largest institutions, based on their increasing percentage of share ownership. Although this has been a long-term trend, it has continued steadily in recent years. The following chart shows the average ownership stake held in S&P 500 companies by Vanguard, Fidelity, State Street and Blackrock, which were the four largest U.S. institutional investors in each year:<sup>7</sup>



The SEC’s recent proposal to provide dissident shareholders with the ability to list company nominees on the dissident proxy card could make this concentration of share ownership even more impactful. If a dissident shareholder can solicit proxies for a majority of shares, thereby triggering the use of a universal proxy card, by reaching out to a small number of large shareholders, it would be much less costly for them to run a proxy contest. See “Other Activism Developments” for a further discussion.

### D. INSTITUTIONAL INVESTOR ENGAGEMENT EFFORTS

In recent years, the largest institutional asset managers have emphasized their focus on engagement and governance. These institutions have developed robust internal proxy advisory functions and have underlined to companies that responsiveness to activist investor demands or proxy advisory firm recommendations is no substitute for direct engagement with significant shareholders. In January 2012, BlackRock sent the [first in a series of letters](#) to hundreds of public company chairs and CEOs, highlighting BlackRock’s detailed voting policies and governance expertise, and encouraging companies to engage directly and not rely solely on the recommendations of proxy advisory firms. In 2015, BlackRock updated its voting policies to emphasize the importance of direct engagement and to make clear that the policies are more than just guides to how BlackRock votes—they represent BlackRock’s “expectations of boards

<sup>7</sup> Based on data provided by CamberView Partners.

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of directors.” Similarly, Vanguard sent letters to portfolio companies beginning in 2012 cautioning companies not to confuse Vanguard’s “predominantly passive management style” with a “passive attitude toward corporate governance.” The letter goes on to emphasize numerous corporate governance principles and to highlight in detail the importance of direct engagement. The [2015 version](#) of the Vanguard letter focused in particular on the need for board oversight of shareholder engagement efforts.

In 2015 and 2016, the attention of a number of large institutional investors turned to the potential consequences of board responses to shareholder activism on long-term value. For example, in 2015, BlackRock sent [letters](#) to CEOs of large-cap companies urging them not to take short-term actions, such as buybacks and increased dividends, that may satisfy the demands of short-term activists but that impair long-term value. In 2016, BlackRock sent [another round of letters](#), urging companies to articulate a strategic framework for long-term value creation to serve as a counterpoint to activist demands for actions with short-term benefits. In addition, Vanguard’s letters have emphasized the importance of engaging with long-term investors, and some of the largest institutional investors have joined industry initiatives to combat an overemphasis on short-term results, including as signatories to the CommonSense Corporate Governance Principles<sup>8</sup> and as members of Focusing Capital on the Long Term.<sup>9</sup>

Most recently, in October 2016, State Street Global Advisors (SSGA) issued a market commentary that pointedly raises the concern that, under pressure from activists, companies may pursue short-term interests at the expense of longer-term results. The SSGA commentary focuses on settlement agreements between public companies and activists seeking board seats and sets out the following concerns and observations:

- Settlement agreements that are entered into quickly and without appropriate consultation with other shareholders deprive long-term shareholders of the opportunity to express their views.
- SSGA’s review of the actions of the largest activists identified several red flags that raise questions about the long-term effects of activism, including increases in CEO pay and tying CEO pay to earnings per share, as well as undue focus on share buybacks, spin-offs and other financial engineering.
- Settlement agreements should include terms that protect the interests of long-term investors, which could include requirements that activists meet share ownership thresholds and hold shares for a defined period, as well as restrictions on share pledges by the activist.

SSGA also announced a policy of engaging with companies that pursue previously unplanned financial engineering transactions within a year of a settlement to better understand the reason behind the strategic change.

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<sup>8</sup> The [Principles](#) were issued in July 2016 by representatives of a number of large corporations and institutional investors, including SSGA, BlackRock, Vanguard, Capital Group, CPPIB and T. Rowe Price. For further information, please see our publication, dated July 22, 2016, entitled “[Executive Group Publishes Statement of Commonsense Principles of Corporate Governance](#).”

<sup>9</sup> FCLT is dedicated to developing practical tools and approaches that encourage long-term behaviors in business and investment decision-making. The list of its members is available at: <http://www.fcltglobal.org/members/members>.

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The continued focus of large institutions on corporate governance and long-term value is an important aspect of the ongoing development and maturation of the relationship between public companies and shareholders. Although practice has moved away from the “traditional” approach of presuming that an activist is most likely to be wrong, neither should companies adopt the view that an activist is most likely to be right. As discussed further below under “Steps Companies Should Take,” companies that engage effectively with their long-term shareholders on a regular basis will be best equipped to develop an informed and balanced response to an activist that is well received by long-term investors.

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### ACTIVIST INVESTORS

#### A. TOTAL ACTIVIST CAMPAIGNS

Recent years have seen a continuing increase in the number of activist campaigns announced. In 2015, activists publicly announced a total of 300 campaigns, an increase of 10% over the 272 campaigns announced in 2014, and an increase of 36% over the 221 campaigns announced in 2013.<sup>10</sup> The data shows an increase in both proxy contests and other types of shareholder campaigns, which include public campaigns by activist investors seeking changes at a company with the goals of increasing shareholder value and/or enhancing corporate governance practices. Full scale proxy contests have developed, on average, in approximately one quarter of all activist campaigns announced in each year since 2013.

The data for 2016 to date indicates that the trend of increasing activist campaigns is reversing in 2016, given that the number of campaigns announced as of early November 2016 is slightly below the number announced as of the same date in 2015. As reflected in the graph below, proxy contests make up a smaller percentage of announced activist campaigns in 2016 than has been observed in prior years, which may change as some existing campaigns currently classified as other shareholder campaigns develop into full scale proxy contests in the future.

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<sup>10</sup> Based on information from SharkRepellent.net for companies with market cap over \$100 million. See “Notes on the Scope and Sources of Data Used in this Publication” on page 3.



As discussed further below, the lower activity in 2016 reflects fewer campaigns by the most frequent activists and an increase in campaigns by infrequent activists. We discuss below certain trends in activist hedge fund assets under management, performance and formation, and the increased activity by less frequent activists that help provide context for this shift.

**B. ASSETS UNDER MANAGEMENT BY ACTIVIST HEDGE FUNDS**

From the early 2000s until the economic downturn in 2008, assets under management (AUM) by activist hedge funds grew each year. After a short period of retrenchment, this growth resumed as the economy recovered. From 2013 to mid-2015, the growth rate of AUM by activist hedge funds was significantly higher than the growth rate experienced by the hedge fund industry as a whole. Activist AUM grew on average 7% per quarter over this time period, whereas all other hedge funds grew at an average rate of less than 3% per quarter.<sup>11</sup>

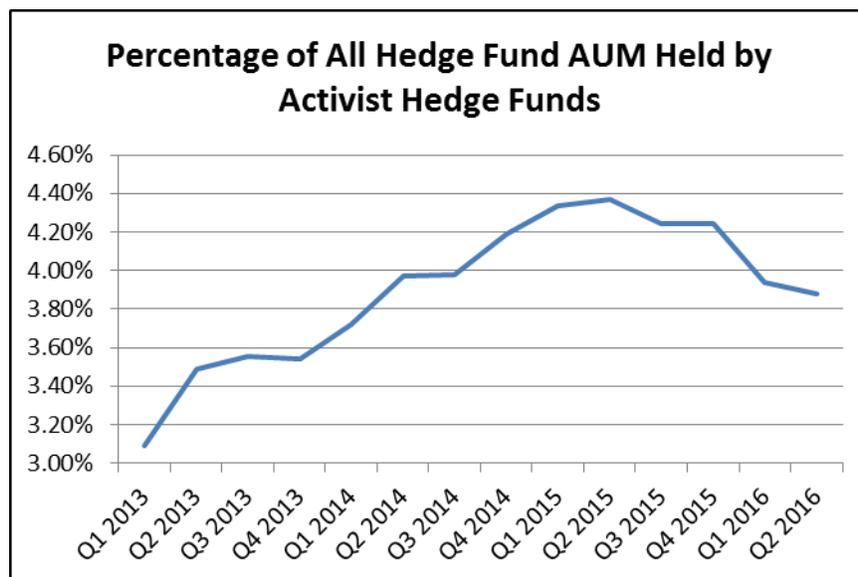
However, from mid-2015 to mid-2016, this trend reversed, with activist AUM declining significantly, as indicated in the table below. Although other hedge funds experienced declining AUM in this period, it was not nearly as marked a decline as experienced by activist funds.

<i>AUM (in billions) and Percentage Change Per Half Year</i>							
	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016
Activist Funds:							
AUM	\$84	\$93	\$111	\$119	\$129	\$122	\$112
% Change	29%	11%	19%	7%	9%	(5%)	(9%)
Other Hedge Funds:							
AUM	\$2,330	\$2,535	\$2,689	\$2,725	\$2,839	\$2,773	\$2,785
% Change	7%	9%	6%	1%	4%	(2%)	0%

<sup>11</sup> Based on information from HFR. See “Notes on the Scope and Sources of Data Used in this Publication” on page 3.

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As a result of these developments since mid-2015, the activist hedge funds' AUM has declined as a percentage of total hedge fund AUM for the first time in recent years.



The recent declines in activist AUM are the combined product of withdrawals/redemptions made by activist hedge fund investors and negative activist hedge fund performance over the relevant time period, as discussed further below.

### C. ACTIVIST HEDGE FUND WITHDRAWALS AND REDEMPTIONS

During the first half of 2016, activist hedge funds experienced negative net asset flows for the first time since 2009. In total, withdrawals and redemptions have exceeded new investments by over \$5 billion at activist hedge funds. Comparatively, net outflows at activist hedge funds represented nearly 5% of AUM, whereas outflows at all other hedge funds represented less than 1% of AUM.

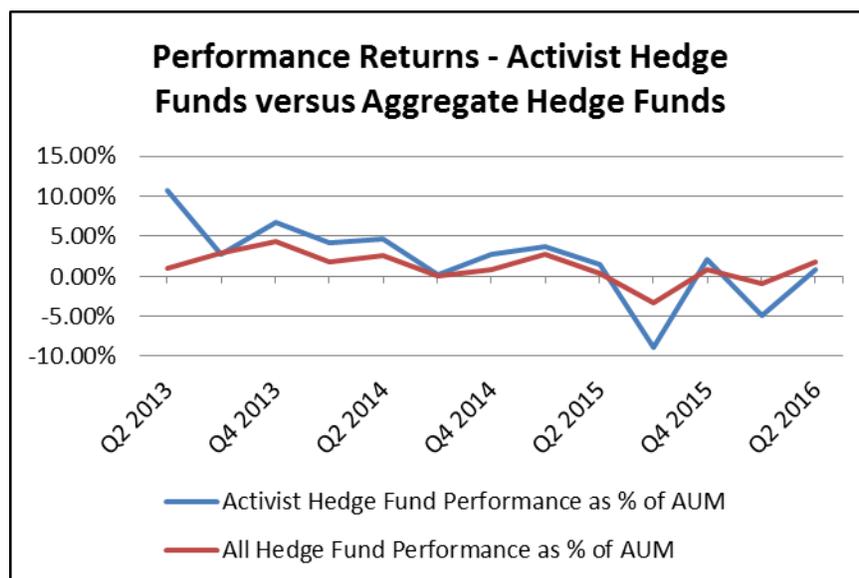
The withdrawals and redemptions account for approximately half of the over \$10 billion reduction in AUM at activist hedge funds experienced in the first half of 2016, with the balance being loss in value due to performance. Although it is too early to predict whether activist hedge funds have hit a ceiling in terms of available investor capital, the disproportionate amount of outflows suggest, at a minimum, that any headwinds encountered by these funds in identifying and capitalizing on activism opportunities can raise significant fundraising and fund-retention challenges.

### D. ACTIVIST HEDGE FUND PERFORMANCE

Activist hedge funds had consistently outperformed hedge funds as a whole from the beginning of 2013 to mid-2015. During this time period, activist hedge funds had an average return of 4.1% per quarter,

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whereas all hedge funds in aggregate had an average return of 1.8%.<sup>12</sup> However, activist hedge funds have generally been more volatile than hedge funds in the aggregate, and this volatility continued during periods of more recent periods of hedge fund losses. From mid-2015 to mid-2016, activist hedge funds on average have experienced losses of 2.7% per quarter, whereas hedge funds as a whole experienced average losses of only 0.4% per quarter.

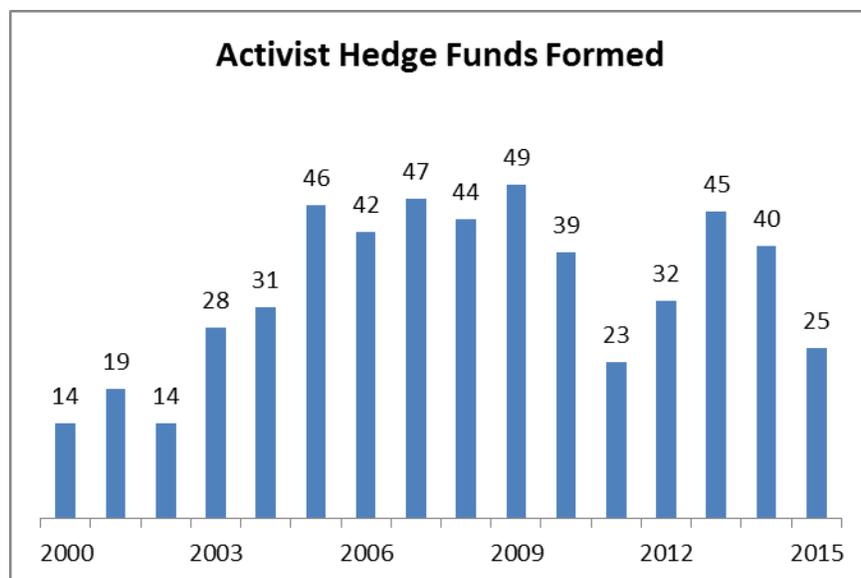


### E. FORMATION OF ACTIVIST HEDGE FUNDS

The formation of activist hedge funds has in large part paralleled the performance of activist hedge funds over time, with periods of better performance resulting in the formation of more hedge funds. In particular, as demonstrated in the graph below, the formation numbers have generally increased, save for a decline in the years following the financial crisis.<sup>13</sup> From 2012 through 2015, activist formation recovered to approach pre-crisis levels. More recently, however, in 2015 formation has begun to trail off, perhaps reflecting the more limited opportunity set for activism that has led to the 2015 and 2016 performance downturn.

<sup>12</sup> For internal consistency, performance returns in this section were calculated by subtracting net asset flows from the total change in AUM, and percentage were calculated by dividing the performance return by the relevant AUM. The underlying data is based on information from HFR. See "Notes on the Scope and Sources of Data Used in this Publication" on page 3.

<sup>13</sup> Based on 2016 Preqin Global Hedge Fund Report.



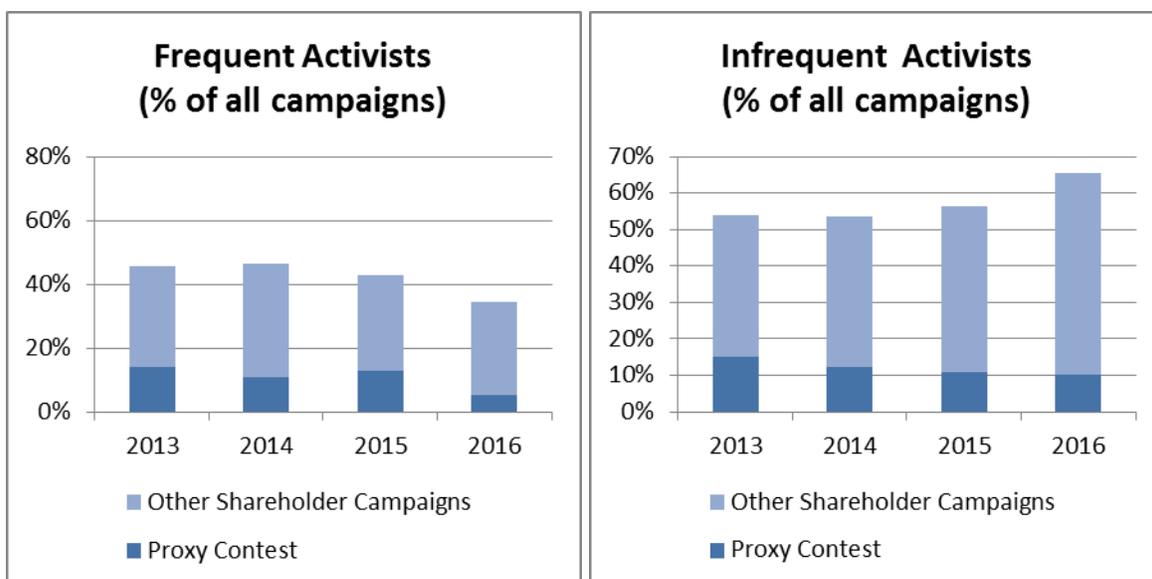
**F. INCREASE IN ACTIVIST CAMPAIGNS BROUGHT BY LESS FREQUENT ACTIVISTS**

In past years, a small number of activist investors have dominated the activist space, making up a large portion of the total number of public activist campaigns. In 2013, more than 14% of proxy contests and approximately 46% of all announced campaigns were led by frequent activists, which we have defined for purposes of this publication as those that have each brought more than five campaigns since the beginning of 2013. So far in 2016, these percentages have declined to 5% and 29%, respectively, indicating much less activity by the more seasoned activists. As discussed above, however, the total number of activist campaigns announced in 2016 is on pace to be equal to, or only slightly less than, those announced in 2015. This is due to the decrease in activity by frequent activists (who more often target large companies) being offset by a significant increase in activity by investors that are relatively infrequent initiators of shareholder activism (that is, those that have each brought five or fewer campaigns since the beginning of 2013). These infrequent activists<sup>14</sup> have generally targeted smaller and mid-cap companies, as discussed in the following section.

<sup>14</sup> Though we have divided investors bringing activist campaigns into frequent activists and infrequent activists for descriptive purposes, the latter group includes both newly formed activist funds and established investors with no recent history of activism.

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The percentage of campaigns brought by infrequent activists compared to frequent activists has increased annually over the past several years, including the year-to-date 2016, as shown in the following charts:



### G. FREQUENT ACTIVIST INVESTORS

Although the most frequent activists have been less active in 2016, they continue to represent a large portion of announced campaigns. In recent years, the most frequent activists tend to announce between eight and 10 activist campaigns per year. The most frequent activists from 2013 through 2016 were as follows:

<i>Announced Campaigns by Most Frequent Activists<sup>15</sup></i>	
<b>2013</b>	
GAMCO Asset Management, Inc.	10
Starboard Value LP	10
Clinton Group, Inc.	8
<b>2014</b>	
Starboard Value LP	10
GAMCO Asset Management, Inc.	9
Lone Star Value Management, LLC	8
<b>2015</b>	
GAMCO Asset Management, Inc.	11
Bulldog Investors, LLC	9
Elliot Management Corporation	8
<b>2016 YTD</b>	
Elliot Management Corporation	7
Bulldog Investors, LLC	5
Starboard Value LP	3

<sup>15</sup> Based on information from SharkRepellent.net for companies with market cap over \$100 million. See "Notes on the Scope and Sources of Data Used in this Publication" on page 3.

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## H. PROMINENT ACTIVIST INVESTORS

As discussed further in the section “Target Companies by Market Capitalization” below, a significant percentage of Fortune 100 companies have been the targets of activist campaigns. But given the capital required to raise a significant stake in large-cap companies, only a small number of prominent activist investors have targeted Fortune 100 companies. As summarized in the table below, only eight investors have announced more than one activist campaign against a Fortune 100 target company since 2013.

<i>Fortune 100 Campaigns 2013–16</i>	
<i>Activist</i>	<i>Campaigns</i>
Triun Fund Management, L.P.	4
Value Act Capital Management LP	4
Icahn Associates Corp.	4
Pershing Square Capital Management	3
Fairholme Capital Management LLC	3
JANA Partners LLC	2
Southeastern Asset Management, Inc.	2
Paulson & Co., Inc.	2

## I. MOST SUCCESSFUL ACTIVISTS BY BOARD SEATS OBTAINED

Activists have obtained board seats as a result of their efforts at a remarkably consistent rate in recent years. As summarized in the table below, activists on average have received just over one board seat for every two campaigns announced in a particular year.<sup>16</sup>

<i>Board Seats Obtained by Activists</i>				
	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016 YTD<sup>17</sup></i>
Total Board Seats Obtained	128	169	173	63
Number of Total Completed Campaigns	221	272	300	117
Average Board Seats Per Campaign	0.57	0.62	0.57	0.54

Not surprisingly, the activists that have been the most successful at obtaining board seats are generally those who are the most prolific in terms of number of campaigns. Icahn Associates is a notable exception, in that it has not been in the top three most frequent activists in any year during the period.

<i>Number of Board Seats Obtained By Most Successful Activists</i>				
	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016 YTD</i>
Starboard Value LP	7	24	13	5
Icahn Associates Corporation	5	5	9	3
Elliot Management Corporation	5	7	6	5

<sup>16</sup> Based on information from SharkRepellent.net for companies with market cap over \$100 million. See “Notes on the Scope and Sources of Data Used in this Publication” on page 3.

<sup>17</sup> 2016 percentage was calculated using the number of completed campaigns, so excludes open campaigns.

## TARGET COMPANIES

### A. TARGET COMPANIES BY MARKET CAPITALIZATION

The following sets forth the market cap of companies targeted by activist campaigns announced since the beginning of 2013, with the first row indicating the allocation of *all* U.S. public companies in each range.<sup>18</sup>

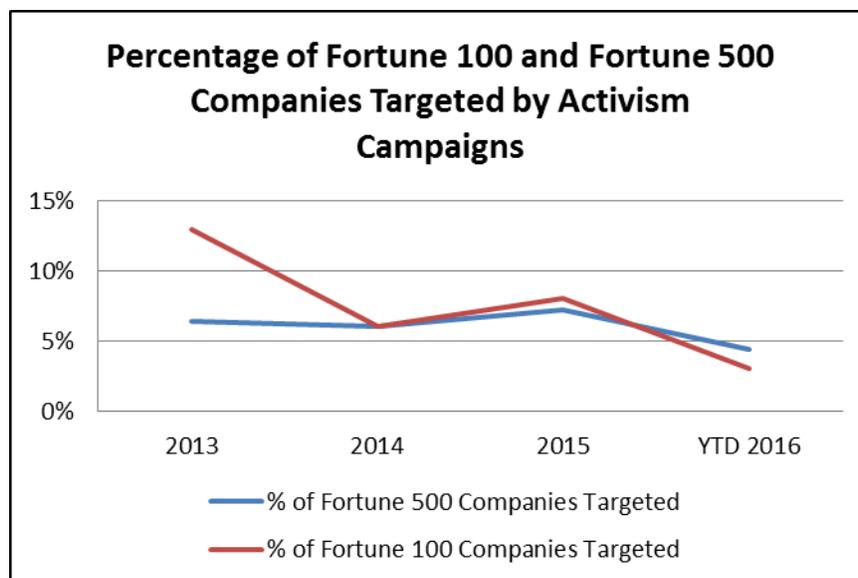
<i>Target Company Market Capitalization</i>					
	<i>\$100–\$500m</i>	<i>\$500m–\$1b</i>	<i>\$1b–\$10b</i>	<i>\$10b–\$50b</i>	<i>&gt;\$50b</i>
<i>Percentage of total companies</i>	28%	16%	43%	10%	3%
2013 campaigns	38%	14%	35%	7%	3%
2014 campaigns	42%	14%	33%	6%	5%
2015 campaigns	45%	15%	29%	8%	3%
2016 YTD campaigns	42%	18%	31%	7%	2%

The above table indicates that the frequency of activist campaigns in each range is generally proportionate to the number of companies in each range—that is, activists are not, to any significant degree, targeting one particular size of companies disproportionately. That said, the table does show that smaller companies tend to be targeted somewhat more frequently, with companies whose market cap is between \$100 million and \$500 million representing from 38–45% of campaigns, while representing only 28% of public companies. In contrast, companies with market caps over \$1 billion are slightly less likely to be targeted.

The fact that companies across the market cap spectrum are targets of activism on a relatively consistent basis is notable, given the larger investment that is necessary for an activist to gain traction at larger companies. Approximately 10% of the campaigns in each year targeted companies with market caps of greater than \$10 billion, with companies of greater than \$50 billion making up around 3% of total campaigns.

The upshot is that even the largest companies are in no way immune from activist campaigns. The following chart shows that a significant percentage of Fortune 100 and Fortune 500 companies have been targets of activist campaigns in each of the past few years.

<sup>18</sup> As discussed further in “Notes on the Scope and Sources of Data Used in this Publication” on page 3, we have based this analysis on information from SharkRepellent.net, and limited our analysis to U.S. companies with a market capitalization of over \$100 million.



The decline for 2016 is due in part to the fact that it only includes information on campaigns announced through early November, but is also likely due in part to the relative decline in activity from the most well-financed and seasoned activists. As discussed above, activist demands in 2016 have included a larger number of infrequent activists, who have tended to target smaller and mid-cap companies.

**B. INDUSTRIES OF TARGET COMPANIES**

Activists have targeted a wide variety of industries since 2013. The most targeted industries, which have generally been consistent in each year, include investment vehicles (including investment trusts and mutual funds), pharmaceutical companies, software companies, other commercial service providers and regional/mid-sized banks.<sup>19</sup>

<i>Most Targeted Industries 2013 to 2016</i>	
<i>Industry</i>	<i>Total Campaigns</i>
Investment Trusts / Mutual Funds	51
Packaged Software	41
Miscellaneous Commercial Services	40
Major Pharmaceuticals	32
Regional/Mid-sized Banks	29

In addition to the above, particular industries that have been targeted in 2016 more than in prior years include real estate development, semiconductors, medical specialties and movies/entertainment.

<sup>19</sup> Industry classifications based on data from SharkRepellent.net. See “Notes on the Scope and Sources of Data Used in this Publication” on page 3.

## TYPES AND OBJECTIVES OF ACTIVIST CAMPAIGNS

Initiating or threatening to initiate a proxy contest for representation on a company’s board of directors is a common strategy used by activists to achieve their campaign objectives. A proxy contest occurs when an activist nominates one or more directors for election in opposition to a public company’s slate of director nominees. Activists also conduct campaigns through other avenues and tactics, all of which we have included in the general category of “other shareholder campaigns”; this can include publicly disclosing letters to target companies, issuing press releases, proposing precatory or binding shareholder proposals, running “vote no” campaigns against incumbent directors, calling special meetings or taking actions by written consent.<sup>20</sup>

### A. FREQUENCY OF DIFFERENT CAMPAIGN TYPES

As noted above, activist campaigns, including both proxy contests and other shareholder campaigns, have been continuously growing since 2013, though appear to be lower in 2016.

<i>Number of Campaigns Announced Per Year</i>			
	<i>Proxy Contests<sup>21</sup></i>	<i>Other Shareholder Campaigns</i>	<i>Total</i>
2013	65	156	221
2014	62	210	272
2015	73	227	300
YTD 2016	32	177	209

On a relatively consistent basis, 20 to 30% of activist campaigns have taken the form of actual proxy contests. The percentage is lower for campaigns announced in 2016, which is due in part to the fact that the above numbers include only completed contests, not pending ones, and that some of the campaigns currently categorized as “Other” may yet evolve into actual proxy contests later this year or in 2017.

### B. UNDERLYING OBJECTIVES OF ACTIVIST CAMPAIGNS

Although board representation remains the most common objective in activist campaigns, it is almost always sought to promote other underlying objectives. In past years, the most common underlying objectives of proxy contests related to business strategies, balance sheet actions (such as returning cash to shareholders through dividends or share repurchase) and divestitures or other M&A actions (such as encouraging a sale of the target company or opposing a merger) by target companies. In 2016, proxy contests have more commonly been focused on board-related governance issues, with balance sheet

<sup>20</sup> These categories align with “Proxy Fights” and “Other Stockholder Campaigns” used by SharkRepellent.net. We have not included SharkRepellent.net’s other categories of “Exempt Solicitations” and “13D Filings Without Public Activism” as activist campaigns in this publication, as they more often reflect ordinary course shareholder interaction rather than true activist situations. See “Notes on the Scope and Sources of Data Used in this Publication” on page 3 for a further discussion.

<sup>21</sup> Throughout this section, to aid comparison of outcomes across years, we have included only proxy contests that have completed, not those that remain pending. This results in a lower number of contests for 2016 in particular than would appear if the outcome of all pending contests was known.

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issues and M&A actions less of a focus. In addition, over the past two years, an increasing number of proxy contests have included a focus on compensation-related issues.

<i>Objectives of Proxy Contests</i> <sup>22</sup>				
<i>Issue</i>	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016 YTD</i>
Business Strategies	40%	44%	34%	22%
Balance Sheet	31%	35%	53%	28%
M&A	31%	27%	40%	22%
Board-Related Governance	18%	26%	26%	38%
Compensation	3%	5%	11%	13%
Other Governance	6%	19%	8%	3%

The top three objectives of other shareholder campaigns relate to business strategies, balance sheet actions and M&A actions, with a push for divestitures and other M&A actions being the dominant objective in the past few years, as indicated in the following table.

<i>Objectives of Other Shareholder Campaigns</i> <sup>21</sup>				
<i>Issue</i>	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016 YTD</i>
Business Strategies	29%	23%	24%	25%
Balance Sheet	29%	26%	21%	15%
M&A	24%	31%	37%	34%
Board-Related Governance	6%	7%	11%	11%
Compensation	1%	4%	7%	6%
Other Governance	3%	0%	2%	1%

### C. TACTICS USED BY ACTIVISTS

The most common tactics in the activists' playbook (aside from nominating a director slate) are publicity campaigns (including publicly disclosing letters to the company and issuing press releases) and, less commonly, putting forth shareholder proposals. The following sets forth how frequently each of these tactics was used in activist campaigns announced in each year.

<i>Tactics Used in Activist Campaigns</i>		
	<i>Public Disclosure by Activist</i>	<i>Shareholder Proposals</i>
2013	53%	9%
2014	42%	5%
2015	46%	6%
YTD 2016	34%	6%

The decline during 2016 of the public airing of concerns may be due to an increased focus by companies on engagement with an activist, and often even settlement with an activist, before the demands are made public. This trend is consistent with the concerns raised by SSGA, as discussed in "Institutional Investors" above.

Other tactics that are used from time to time, including initiation of litigation and the calling of a special meeting, happen relatively rarely—in less than 5% of campaigns over this period.

<sup>22</sup> The percentages in these tables add to over 100% because single campaigns often have multiple objectives.

**D. STRUCTURAL AND BEHAVIORAL ACTIONS USED BY COMPANIES IN RESPONSE TO ACTIVISM**

Target companies respond to activist campaigns with a variety of structural and behavioral actions, some designed to create obstacles for activists and some designed to address shareholder concerns. Actions taken by target companies during campaigns include substantive business steps (such as hiring advisors to evaluate strategic alternatives, and returning cash to investors through dividends or buybacks), governance changes (including those viewed as governance enhancements by shareholders) and tactical actions (such as adoption or revision of poison pills, calling of a special meeting, adjourning or postponing meetings, initiation of litigation, or changing board size).<sup>23</sup> The most frequently taken action during a campaign is to return cash to shareholders, though this has been less common so far in 2016. More aggressive tactical steps, such as adoption of poison pills and initiation of litigation, are relatively uncommon at this point during a campaign.

<i>Actions Taken by Target Companies in Response to Activism</i>				
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>YTD 2016</b>
<b>Substantive Actions</b>				
Act to Increase Shareholder Value (e.g., buybacks or dividends)	17%	8%	21%	10%
Hire Advisors to Evaluate Strategic Alternatives	6%	3%	8%	4%
<b>Governance Changes</b>				
Other Charter/Bylaw Changes	9%	5%	10%	2%
Amend Advance Notice Requirements	8%	2%	4%	1%
Corporate Governance Enhancement	8%	1%	3%	3%
<b>Tactical Actions</b>				
Increase Size of Board	8%	5%	17%	9%
Adopt of Poison Pill	6%	7%	1%	2%
Adjourn Meeting	4%	0%	1%	1%
Postpone Meeting Date	2%	1%	3%	1%
Amend Poison Pill	1%	0%	1%	1%
Decrease Size of Board	1%	2%	3%	1%
Call Special Meeting	1%	1%	1%	1%
Initiate Litigation	<.5%	<.5%	1%	0%

**PROXY CONTESTS**

As noted above, initiating a proxy contest for representation on a company's board of directors is one of the primary strategies utilized by activists to achieve their campaign objectives. Defending against a proxy contest requires a public company to expend considerable time and resources as it undertakes to demonstrate to its shareholders that its director candidates are best positioned to lead the company. As a result, a company may choose to settle with an activist for minority board representation, and accept the risk of prolonged controversy or even disruption in the boardroom, rather than taking the risk of engaging in a public proxy contest. This section will analyze certain key statistics and trends regarding proxy

<sup>23</sup> The categorizations of defensive actions taken are derived from those used by SharkRepellent.net.

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contests, which may inform strategies for approaching a potential proxy contest. It should be noted, however, that overall statistics tell only part of the story, as the decision whether or not to settle in individual cases will depend on the particular facts and circumstances.

### A. HOW OFTEN ARE PROXY CONTESTS SETTLED?

<i>Proxy Contests: Frequency of Votes, Settlements and Withdrawals</i>							
	<i>Total Number</i>	<i>Went to Vote</i>	<i>Percentage</i>	<i>Settled/Concessions Made</i>	<i>Percentage</i>	<i>Withdrawn</i>	<i>Percentage</i>
2013	65	26	40%	26	40%	13	20%
2014	62	14	23%	32	52%	16	26%
2015	73	26	36%	35	48%	12	16%
YTD 2016	32	8	25%	17	53%	7	22%

In 2015, the total number of proxy contests exceeded by 10% the total number of contests in each of 2013 and 2014. So far in 2016, there has been a significant drop-off in the number of reported proxy contests. However, this decline may not be due to lower activist interest in obtaining board representation but rather may reflect a management trend toward engaging in private discussions with activist investors to understand and resolve the shareholder's concerns before a potential proxy contest is made public. Given that the percentage of completed contests going to a vote has been 40% or less in each of the last four years, it suggests that the company and activist investors are more frequently willing to accept a compromise.

<i>Proxy Contests Settled After the Date of the Definitive Proxy Statement</i>				
	<i>Proxy Contests That Went Definitive</i>	<i>As a Percentage of Total Proxy Contests</i>	<i>Proxy Contests Settled After Definitive Date</i>	<i>As a Percentage of Proxy Contests That Went Definitive</i>
2013	38	59%	9	24%
2014	23	37%	5	22%
2015	36	49%	5	14%
YTD 2016	16	50%	6	38%

Since 2013 companies and activists have been able to settle, on average, one in five proxy contests that extend beyond the date that the proxy statements for both sides go "definitive"—in other words, closer in time to the date of the shareholders' meeting at which directors are elected. This trend, which is even more distinct thus far in 2016, demonstrates that the initiation of a proxy contest does not necessarily mean an end to continuing efforts by the company and activist to communicate and seek resolution.

### B. RESULTS OF RECENT PROXY CONTESTS

<i>Proxy Contests – Short vs. Control Slate</i>							
	<i>Number of Proxy Contests With Short Slate</i>	<i>Percentage of Proxy Contests With Short Slate</i>	<i>Activist Wins at Least One Board Seat (Short Slate)</i>	<i>Number of Proxy Contests With Control Slate</i>	<i>Percentage of Proxy Contests With Control Slate</i>	<i>Activist Wins at Least One Board Seat (Control Slate)</i>	<i>Activist Wins Majority of Board Seats (Control Slate)</i>
2013	24	37%	58%	41	63%	46%	15%
2014	18	29%	67%	44	71%	52%	14%
2015	24	33%	42%	49	67%	38%	8%
YTD 2016	11	34%	36%	21	66%	43%	14%

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Since 2013, activist investors have continued to be aggressive with the level of control they seek through their proxy contests. In the last four years the percentage of proxy contests involving a control slate, or a slate for more than a majority of the board seats, has ranged from 63% to 71%. This suggests that at the outset of a proxy contest, many activist investors are not content to merely gain a seat at the table to influence the direction of the company but rather are seeking the ability to control the direction of the company, or at a minimum are willing to threaten a control attempt in order to gain negotiating leverage. Over the last four years, approximately 47% of all proxy contests, short or control slates, resulted in the activist investor obtaining one or more seats on the board.

<b>Short Slate Contests – Percentage of the Board Sought</b>				
	<b>Number of Short Slate Contests</b>	<b>Dissident nominees for &lt; 15% of Board</b>	<b>Dissident nominees for 15% ≤ x &lt; 30% of Board</b>	<b>Dissident nominees for 30% ≤ x ≤ 50% of Board</b>
2013	24	21%	29%	50%
2014	18	0%	44%	56%
2015	24	8%	50%	42%
YTD 2016	11	27%	36%	36%

When an activist investor puts forward a short slate of directors, or a slate for a minority of the board seats, it is often for more than 15% of the available board seats. After that 15% threshold, which typically equates to one or two nominees, the data shows, with the exception of 2013, a fairly even split between the percentage of times that activist investors seek up to 30% of the board seats, which typically equates to three or four nominees, and the percentage of times they seek up to 50% of the board seats.

<b>Proxy Contest Settlement Frequency – Short vs. Control Slate</b>				
	<b>Number of Short Slate Contests</b>	<b>Percentage of Short Slate Contests Settled/Concessions Made</b>	<b>Number of Control Slate Contests</b>	<b>Percentage of Control Slate Contests Settled/Concessions Made</b>
2013	24	29%	41	46%
2014	18	44%	44	54%
2015	24	25%	49	60%
YTD 2016	11	18%	21	71%

Over the last four years, when an activist investor puts forward a short slate of directors, the activist investor ends up agreeing to settle its proxy contest before a vote approximately 30% of the time on average. In the context of control slates, over the last four years, activist investors have agreed to settle, withdraw or otherwise end their proxy contests before a vote approximately 57% of the time on average. This fairly significant difference in the frequency of the pre-vote resolution of proxy contests in the short versus control slate contexts may have a number of explanations. One explanation is that management may be predisposed to settling in the context of a control slate contest because the cost of losing the contest is much higher. Another potential explanation is that activist investors may be predisposed to settling in the context of a control slate because of the increased resources and expenses required to run a successful campaign for control, as well as the higher burden of persuasion for receiving the recommendation of proxy advisory firms and the vote of other large shareholders, relative to a short slate

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campaign. When deciding what strategy and resources a company should use in responding to a proxy contest, unsurprisingly, the proposal of a short versus a control slate should be a key consideration.

<i>Outcome of Proxy Contests That Went to a Vote</i>			
	<i>Won by Management</i>	<i>Won by Activist</i>	<i>Vote Split</i>
2013	39%	42%	19%
2014	43%	57%	0%
2015	65%	27%	8%
YTD 2016	50%	50%	0%

Of the proxy contests that go all the way to a vote, management's board candidates have been increasingly successful in defeating activist investors' slates of directors. The reasons for companies' success against the activists vary from campaign to campaign. However, these numbers suggest that the trend toward more thoughtful engagement with large shareholders, coupled with campaigns that effectively highlight the past accomplishments and future potential of the current board and management team, can help companies obtain a favorable outcome when a contest goes to a vote.

<i>Outcome of Proxy Contests that Went to a Vote – Short vs. Control Slate</i>						
	<i>Short Slate Contests</i>			<i>Control Slate Contests</i>		
	<i>Won by Management</i>	<i>Won by Activist</i>	<i>Vote Split</i>	<i>Won by Management</i>	<i>Won by Activist</i>	<i>Vote Split</i>
2013	53%	33%	13%	18%	55%	27%
2014	33%	67%	0%	50%	50%	0%
2015	67%	27%	7%	64%	27%	9%
YTD 2016	40%	60%	0%	67%	33%	0%

In the last four years, companies' success in winning contests that go to a vote has been a bit more volatile in short slate contests than in control slate contests. Management slates of directors have seen a fairly rapid year-over-year increase in their success rate with respect to winning control slate votes. One possible explanation is the settlement statistics discussed above. It may be that a company is willing to take greater risks in the context of short slate contests given the reduced impact of a loss and allow more "close call" contests to go to a vote. If more contests go to a vote that could potentially go either the company's or an activist's way, this could explain the year to year swings up and down in management's success rates. In contrast, given the greater negative impact of a control slate contest loss, the company may be increasingly pushing to settle most control slate contests if it feels its slate of directors has any meaningful risk of losing.

### **C. HOW DO PROXY ADVISORY FIRM RECOMMENDATIONS IMPACT A PROXY CONTEST?**

Although their impact may have waned somewhat in recent years, proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis & Co., still have a notable, if not always determinative, effect on the outcome of a proxy contest. These advisory firms set forth policy guidelines as well as make recommendations with respect to proposals to be voted upon at a shareholders' meeting, including contested director elections.

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ISS has been inclined to recommend in favor of at least one activist director candidate in a proxy contest for minority representation on the board of directors if the activist presents a credible case that change is warranted at the company. Since 2013, in the proxy contests in which ISS has issued a recommendation, ISS has recommended for activist investors in approximately 57% of contests and for management in the remaining 43% of contests. Over time, the trend has favored activists, with ISS recommending in support of management 49% of the time in 2013, but only 36% of the time in 2016.

Since 2013, ISS's influence appears to have waned in proxy contests. In 2013, ISS recommendations matched the outcome of the vote in 77% of proxy contests. That figure dropped to 73% and 62% in the years 2014 and 2015, respectively. In year-to-date 2016, ISS recommendations have matched the outcome 63% of the time. This decline is likely due at least in part to the internal proxy advisory functions that many of the larger investment funds have developed, as noted above and may also be due in part to ISS's increased support for activists. Nevertheless, ISS's recommendations still remain consistent with the ultimate outcome of a proxy contest a majority of the time.

Companies facing a proxy contest should be mindful of the relevant policies of the proxy advisory firms, including the status of any concerns the firms have identified about the company in the past, and should assess what steps could be taken to obtain their support. In the event of an adverse recommendation, companies should focus on communicating effective counterarguments to shareholders.

### D. WHAT OCCURS IN THE AFTERMATH OF A PROXY CONTEST?

<i>Company Changes in the Aftermath of a Proxy Contest</i>			
	<i>CEO Change</i>	<i>Merger or Spin-off</i>	<i>Additional Proxy Contests</i>
2013	23%	19%	31%
2014	44%	31%	0%
2015	11%	14%	11%
YTD 2016	11%	0%	0%

The conclusion of a proxy contest, regardless of the outcome, is often a precursor to a number of different types of changes for the company. In the year or so after a proxy contest, it is not uncommon to see changes to senior management, strategic initiatives such as mergers or spin-offs, or the continuation of activist efforts through additional future proxy contests. The table above presents how often certain changes or events occur in the aftermath of all proxy contests that go to a vote. Note that because these changes can take time, the 2016 data should be considered in the light of the fact that there may not have elapsed enough time since each proxy contest concluded for some of these changes to take place.

Interestingly, the frequency of these types of changes do not seem to depend heavily on the outcome of the contest—that is, whether management or the activist won or the vote was split. This may indicate that the issues raised during the course of the contest, including those raised by the activist and those arising in shareholder outreach discussions, can in some cases lead the board and management to conclude that responsive steps should be taken, even if the management slate wins. Before the conclusion of a

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proxy contest, companies should give consideration to what actions could or should be taken to achieve their long-term goals in light of the issues raised during the campaign, regardless of the outcome.

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### SETTLEMENT AGREEMENTS

This section analyzes the publicly filed settlement agreements that have been reached for activist campaigns announced in 2015 and 2016, including the frequency of settlements, the timing of settlement and the key provisions of settlement agreements.

#### A. FREQUENCY AND SPEED OF SETTLEMENT AGREEMENTS

The percentage of settlement agreements that have been filed with the SEC for 2016 campaigns to date as compared to the total number of completed activist campaigns has increased significantly from 2015, as illustrated in the table below.<sup>24</sup>

	<i>Settlement Agreements Filed with the SEC</i>		<i>Filed Settlement Agreements for Proxy Contests</i>		<i>Filed Settlement Agreements for Other Shareholder Campaigns</i>	
	<i>Number</i>	<i>Percentage of Total Completed Campaigns</i>	<i>Number</i>	<i>Percentage of Total Proxy Contests</i>	<i>Number</i>	<i>Percentage of Total Other Shareholder Campaigns</i>
2015	81	25%	22	28%	59	24%
2016 YTD	48	41%	15	43%	33	40%

The speed with which settlement agreements have been reached is generally faster in year-to-date 2016 as compared with 2015, with a significant number of settlement agreements being reached within three months of the initiation of the campaign. For purpose of these calculations, the time when an activist initiates a campaign is deemed as the time when it makes the first public step towards achieving its goal, either by publicizing a letter sent to the company, sending a letter to the other shareholders, filing a Schedule 13D or otherwise publicly announcing its intent to initiate a campaign. Of course, in many cases the company and the activist may have had extensive discussions prior to their being any public knowledge of the campaign, and in some cases the first public announcement comes in the form of a finalized settlement agreement between the parties.

<i>Time between the Initiation of Campaigns and the Date of the Settlement Agreements</i>	<i>Less than 1 month</i>	<i>1–2 months</i>	<i>2–3 months</i>	<i>3–6 months</i>	<i>6 months or more</i>
2015	15%	23%	19%	21%	21%
2016 YTD	30%	27%	22%	17%	4% <sup>25</sup>

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<sup>24</sup> Of the 129 publicly filed settlement agreements for completed campaigns that were announced in 2015 and 2016, 17 are either simple appointment letters without any standstill provisions, or confidentiality agreements that do not have customary provisions in settlement agreements. For the purpose of comparison and review, this section only examines the remaining 112 settlement agreements.

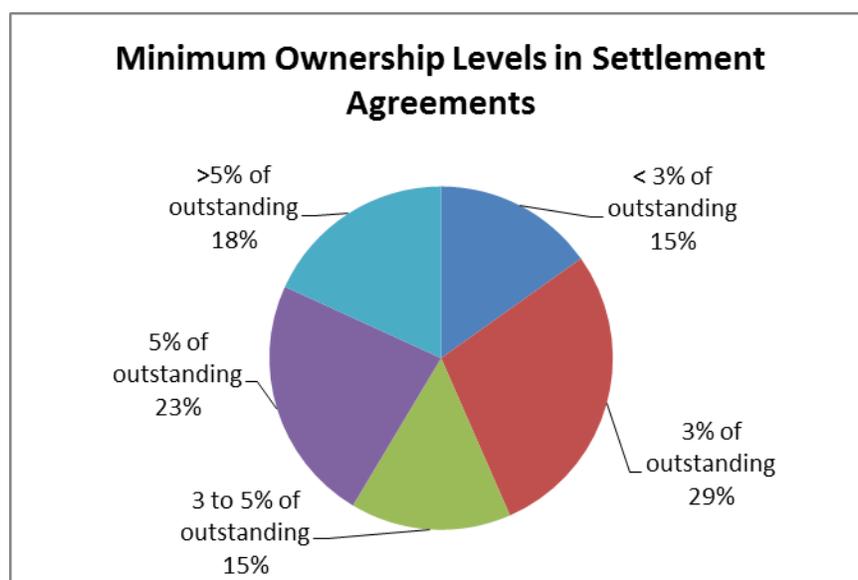
<sup>25</sup> 2016 data for longer-term periods is likely artificially low, since this data includes only completed campaigns, and long-running campaigns announced in mid-2016 will not yet have been completed.

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The increasing frequency of settlements, and the brevity of the period between public announcement of a campaign and its settlement, highlight the concerns raised by SSGA and other institutional investors that companies may be entering into settlements without giving sufficient time for other shareholders to provide their views, as discussed further in “Institutional Investors” above. It is possible that the emphasis of these concerns by institutional investors, together with the reduced stigma of being a target of an activist campaign, may result in fewer companies rushing to settle activist demands without engaging in broader shareholder outreach.

### B. MINIMUM SHAREHOLDING AND DIRECTOR PRE-RESIGNATION PROVISIONS

Of the settlement agreements relating to 2015 and 2016 activist campaigns, 58% have provisions requiring minimum shareholding of the activists in order to keep the directors nominated by such activists on board or to nominate replacements if such directors resign or are otherwise unable to serve. A majority of these provisions set the minimum shareholding threshold at either 3% or 5% of outstanding stock, as indicated in the following chart.



Around 65% of the settlement agreements with minimum shareholding provisions also include a pre-resignation clause requiring the directors to sign, concurrently with their appointments, a resignation letter providing that resignation would take effect if the share ownership of the activist falls below the minimum shareholding threshold or if certain other conditions provided for in the settlement agreement are not met.

### C. STANDSTILL PROVISIONS

Almost every settlement agreement includes a standstill provision, which prohibits activists from engaging in certain activities within a prescribed period of time. The main purpose of the standstill provision is to restrict the activist from initiating or participating in any further campaigns. The standstill period generally runs from the date of the settlement agreement, and ends on a specified period of time after the director

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nominated by the activist leaves the board (or earlier upon a material breach by the company of provisions in the settlement agreement).

The following table lists the types of activities typically restricted by the standstill provisions and the frequency of their inclusion in 2015 and 2016 settlement agreements.

<b>% of Agreements</b>	<b>Activities Prohibited</b>
<b>100%</b>	<b>Publicly disparaging the company or its directors or officers.</b> Prohibits activists from disparaging or negatively commenting on the company or its affiliates or any of their respective officers or directors, including the company's corporate strategy, business, corporate activities, board or management. Of the settlement agreements we reviewed, 85% include a mutual non-disparagement clause that also prohibits the company from publicly disparaging the activists.
<b>99%</b>	<b>Soliciting proxies or consents.</b> Prohibits activists from making, engaging in or in any way participating in, directly or indirectly, any "solicitation" of proxies or consents to vote, or advising, encouraging or influencing any person with respect to the voting of any securities of the company.
<b>96%</b>	<b>Forming a group or a voting trust or entering into a voting agreement.</b> Prohibits activists from forming or participating in any Section 13(d) "group" with any persons who are not their affiliates with respect to any securities of the company or seeking to deposit any securities of the company in any voting trust, or subjecting any such securities to any voting agreements (other than any such voting trust, arrangement or agreement solely among the activists and their affiliates).
<b>96%</b>	<b>Seeking extraordinary transactions not recommended by the board.</b> Prohibits activists from seeking, facilitating or participating in "extraordinary transactions" not recommended by the board. The term "extraordinary transactions" is generally defined to include any tender or exchange offer, merger, consolidation, acquisition, scheme, arrangement, business combination, recapitalization, reorganization, sale or acquisition of assets, liquidation, dissolution or other extraordinary transaction involving the company. Some settlement agreements include an exception that the activists could still tender their shares into any tender or exchange offer or vote their shares with respect to any extraordinary transactions. The prohibition sometimes extends to making public communications in opposition to the extraordinary transactions approved by the board.
<b>95%</b>	<b>Seeking board additions or removals.</b> Prohibits activists from seeking to elect or remove any directors or otherwise seeking representation on the board.
<b>89%</b>	<b>Presenting a shareholder proposal.</b> Prohibits activists from making any proposal at any annual or special meeting of the shareholders.
<b>81%</b>	<b>Seeking amendments or waivers from the standstill or challenging validity of the standstill.</b> Prohibits activists from requesting any waiver of or amendment to the standstill provision or contesting the validity thereof. A majority of the settlement agreements include an exception that such actions could be pursued through non-public communications with the company that would not be reasonably determined to trigger public disclosure obligations.

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<b>% of Agreements</b>	<b>Activities Prohibited</b>
77%	<b>Calling shareholder meetings or referendums.</b> Prohibits activists from calling or seeking the company or any other person to call any meeting of shareholders, as well as action by written consent, or conducting a referendum of shareholders.
71%	<b>Acquiring more shares.</b> Prohibits activists from acquiring, offering to acquire or causing to be acquired beneficial ownership of any securities of the company such that immediately following such transaction the activists would have beneficial ownership of securities exceeding a certain prescribed limit. Settlement agreements generally would clarify that exceeding the limit as a result of share repurchases or other company actions that reduce the number of outstanding shares should not be counted as a breach of this clause.
69%	<b>Entering into third-party agreements that go against the settlement agreement.</b> Prohibits activists from entering into any discussions, negotiations, agreements or understandings with any third party with respect to any activities restricted by the standstill provision.
62%	<b>Requesting a shareholder list or books and records.</b>
58%	<b>Bringing litigation or other proceedings (other than to enforce the settlement agreement).</b> Prohibits activists from instituting or joining any litigation, arbitration or other proceeding (including any derivative action) against the company or its directors or officers other than to enforce the provisions of the settlement agreement. Many settlement agreements also include exceptions for counterclaims with respect to any proceeding initiated by the company against the activists, exercise of statutory appraisal rights or responding to or complying with a validly issued legal process.
49%	<b>Seeking to control or influence the company or the management.</b> While many settlement agreements simply provide for a flat prohibition on any actions designed to control or influence the company or management, some settlement agreements specify the types of activities that are prohibited, including any proposal to change the composition of the board, any material change in the capitalization, stock repurchase programs or dividend policy, any other material change in the company's management, business or corporate structure, amendments to the certificate of incorporation or bylaws, causing a class of securities of the company to be delisted from any securities exchange or become eligible for termination of registration pursuant to Section 12(g)(4) of the Exchange Act.
46%	<b>Transferring shares to a third party.</b> Prohibits transfers of the company's securities to a third party that would result in such third party having aggregate beneficial ownership of more than a certain percentage. Many settlement agreements carve out certain parties from this restriction, such as parties to the settlement agreement, directors and officers of the company and/or affiliates of the company. A small number of settlement agreements also prohibit any short sale or any purchase, sale or grant of any option, warrant, convertible security, stock appreciation right or other similar right.
45%	<b>Publicly announcing intent to go against the settlement agreement.</b> Prohibits activists from making any public disclosure, announcement or statement regarding any intent, purpose, plan or proposal that is inconsistent with the standstill provisions.

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Settlement agreements generally include exceptions that the standstill provisions will not prohibit the activists from communicating privately with the company's directors or officers so long as such communications are not intended to, and would not reasonably be expected to, trigger any public disclosure obligations or restrict any director nominated by the activists in the exercise of his or her fiduciary duties to the company and all of its shareholders.

### D. VOTING AGREEMENTS

88% of the settlement agreements reviewed include a provision requiring the activists to vote their shares in a certain prescribed manner within the standstill period. 20% of the settlement agreements simply require the activist to vote for all the director candidates nominated by the board, and 14% of the settlement agreements require the activists to vote in accordance with all board recommendations. The remaining 54% of settlement agreements either specify certain proposals that the activists must vote for in addition to voting for the board slate (such as ratification of the appointment of an auditor, "say-on-pay" proposals, proposals regarding equity incentive plans, etc.) or include exceptions permitting activists to vote in their own discretion on certain proposals. Customary exceptions to the voting agreement provision include extraordinary transactions that would influence the control of the company, amendments to the company's articles of incorporation, or bylaws that would diminish shareholder rights, or where board recommendation differs from that of ISS or Glass Lewis.

<i>Voting Provisions</i>	<i>Percentage</i>
All board recommendations	14%
Specific board recommendations or exceptions	54%
The board slate only	20%
No voting provision	12%

### E. INFORMATION SHARING

79% of the settlement agreements reviewed include provisions restricting the ability of the directors nominated by the activists to share information of the company with such activists, as follows. 31% of the settlement agreements simply subject the nominated directors to the confidentiality obligations provided for in the company's standard policies, such as the code of business conduct and ethics, insider trading policy and corporate governance guidelines. 22% of the settlement agreements include, in addition to the application of the standard policies, a confidentiality provision or a standalone confidentiality agreement prohibiting information sharing with the activists. 26% of the settlement agreements, including many where the nominated director is an insider of the activist, include a confidentiality provision or a standalone confidentiality agreement which permits information sharing with the activists regarding its investment in the company in certain circumstances.

<i>Information Sharing</i>	<i>Percentage</i>
Apply standard confidentiality policies	31%
Prohibit information sharing with activist	22%
Permit certain information sharing with activist	26%
Information sharing not addressed	21%

## F. EXPENSE REIMBURSEMENT

81% of the settlement agreements reviewed set forth how expenses should be split between the company and the activists. The most common practice is for each party to pay for its own expenses. Some companies agree to reimburse reasonable, documented out-of-pocket fees and expenses (including legal expenses) incurred in connection with the negotiation and execution of the settlement agreements, the nomination of directors and/or the annual meeting, capped at certain amount. It is rare for a company to agree to reimburse expenses incurred by the activists without any cap.

<i>Expense Reimbursement</i>	<i>Percentage</i>
Each party pays for its own expenses	43%
Cap of less than \$100,000	26%
Cap of \$100,000 to \$500,000	22%
Cap of \$500,000 or more	6%
Others (including no cap)	3%

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## OTHER ACTIVISM DEVELOPMENTS

The following summarizes several developments in proxy regulation and practice that may affect the manner in which activist campaigns are conducted.

### A. UNIVERSAL PROXY CARDS

Last month, the SEC proposed the mandatory use of universal proxy cards in all contested director elections at annual meetings of listed U.S. public companies. A universal proxy card would replace competing proxy cards and instead list all candidates on a single card, allowing shareholders to vote for nominees put forth by both parties. This would result in a proxy card containing more nominees than there are board seats up for election. Directors would be selected by plurality vote, as is the case in all contested elections, with the nominees who receive the largest number of “for” votes being elected to the board. The proposal would require the dissident shareholder to solicit proxies with its own proxy statement from the holders of at least a majority of the shares entitled to vote in the director election.<sup>26</sup>

The proposal would also change the definition of “bona fide nominee” in Rule 14a-4(d) to permit proxy cards to include any nominee who agrees to be named in any proxy statement relating to the next meeting of shareholders at which directors are to be elected. This would allow dissident shareholders to include company nominees directly on their proxy card.

The SEC staff stated at the open meeting that the mandatory use of universal proxy cards is not intended to favor either issuers or dissidents in proxy contests but rather to enhance voting flexibility for shareholders unable to attend the annual meeting. The ultimate effect is uncertain and may vary

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<sup>26</sup> For a detailed discussion of the SEC’s proposal, see our publication, dated October 27, 2016, entitled “[SEC Proposes to Require Universal Proxy Cards for All Contested Director Elections.](#)”

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depending on the details of a particular contest. Many commentators, however, have raised concerns about the use of universal proxy cards. Some potential effects include the following:

- The use of universal proxy cards could favor dissidents by making a vote for dissident nominees more appealing due to the flexibility in selecting a mix of directors. Any change that favors dissidents could ultimately lead to more proxy contests and therefore higher costs and disruptions for reporting companies and their shareholders generally.
- The ability of dissidents to list company nominees on their proxy card makes it easier for them to produce a card that institutional investors will view as a suitable replacement for the company card. Due to the concentration of ownership in a small number of large investors,<sup>27</sup> a dissident may be able to solicit proxies for a majority of shares by reaching out to a relatively small number of shareholders. This would greatly reduce the cost of a proxy solicitation and, if the number of shareholders solicited is 10 or fewer, would result in the solicitation being exempt from the proxy filing rules under Rule 14a-2. Conceivably, in particular cases, this use of universal proxy cards could supplant proxy access as a means for shareholders to get their nominees on the board in a cost-effective manner, without meeting the proxy access ownership or other requirements.
- The practice could lead to confusion and undesired outcomes, given that each shareholder could vote for a mix of directors that differs from that preferred by either the company or the activist.
- The practice also may lead to more invalid votes due to shareholders voting for more candidates than there are available seats.
- The proposal does not require the dissident to solicit all shareholders and would likely lead to retail shareholders being provided with less information.
- The ability to split the vote with universal proxies may increase the influence of proxy advisory firms because shareholders would be able to implement the firms' recommendations to split their vote among any combination of directors, not merely vote for the company slate or the dissident slate.

### B. PROXY ACCESS

Proxy access bylaws are becoming mainstream at the largest public companies and are generally favored by shareholders at any company where they are the subject of a proposal. Nearly 400 public companies have adopted proxy access bylaws to date, including 75% of the S&P 100. As more issuers have adopted proxy access, market practice has coalesced around certain relatively standard terms, including 3%/three-year ownership requirements, group size limits of 20 shareholders and director caps equal to 20% of the board.

#### 1. Proxy Access and Proxy Contests at the Same Meeting

Companies manage the interplay between proxy access and proxy contests in a variety of ways. Over 70% of proxy access bylaws adopted by public companies in 2016 provide that proxy access shall not be available at all at any meeting at which the company has received a director nomination under the advance notice bylaw. Of the companies that do not prohibit proxy access in these circumstances, about half reduce the maximum number of proxy access nominees by the number of advance notice nominees.

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<sup>27</sup> See "Institutional Investors" above.

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More recently, a significant number of companies have reduced the maximum number of proxy access nominees by the number of candidates nominated by the company as part of a settlement, even if the advance notice nomination was never made.

Some shareholders and shareholder groups have expressed concerns over limiting proxy contests and proxy access at the same meeting. In ISS's FAQ about actions required in response to a successful proxy access shareholder proposal, ISS includes this limitation in its list of "potentially problematic" proxy access provisions, and the NYC Comptroller has indicated to companies that it prefers the reduction of the number of access nominees, but not below one. It is unclear if these objections will result in any change in market practice.

### 2. Proxy Access as an Alternative to Proxy Contests

No proxy access candidates have yet come to a vote at any public company. On November 10, 2016, GAMCO Asset Management, Inc. became the first shareholder to make a nomination under a proxy access bylaw, filing a [Schedule 14N](#) with the SEC announcing its intent to nominate a candidate at the 2017 annual meeting of National Fuel Gas. On November 25, National Fuel Gas rejected the proxy access nomination, based on its board's determination that GAMCO's control intent makes it ineligible to use the proxy access bylaw. GAMCO owns 8% of the company's outstanding stock and has owned over 5% since 2010; its attempted use of proxy access is a continuation of a multi-year activism push, which has included precatory shareholder proposals and public statements advocating changes to the company's business strategy.

It is unclear at this stage whether, and in what context, proxy access will become a feasible tool for activists to use (or threaten to use) as an alternative to launching a proxy contest. Many of the common terms of proxy access bylaws make them less appealing to activists, including the requirement to affirm the absence of a control intent, the three-year holding period, which is inconsistent with many activist investors' historical investment periods, the limit on the number of access nominees, and the 500-word limit on supporting statements. In addition, the notice periods for proxy access are typically significantly earlier than the advance notice deadline, and a nomination under a proxy access bylaw requires contemporaneous filing of a detailed Schedule 14N with the SEC, together with the provision to the company of more information than may be required under the advance notice bylaw. Nevertheless, proxy access does give smaller shareholders the ability to impose significant costs on the company in terms of time and expense and could be used as an effective bargaining tool in an activism context.

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## STEPS COMPANIES SHOULD TAKE

Developing practices in shareholder engagement, in particular the greater communication among companies and institutional investors, have led to an environment that is, in some ways, more challenging for activists. However, if shareholder engagement lapses into a perfunctory exercise involving meetings

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with little substance, it will provide an opportunity for activists to once again capitalize on investor discontent. The following are some observations on how to deal with activism as a continuing reality:

***There is no “one size fits all” approach to activism.*** Every company’s situation is different, and every activist is different. Small differences in circumstances can lead to substantial differences in options available to optimize outcomes. Considerations may include, among others, identity of shareholders, total shareholder return of the company in recent years, both in absolute terms and relative to peers, identity and track record of activists, nature of an activist platform, size of equity capitalization, the media profile of the company and activists, and overall governance profile of the company. The governance profile includes not only structural defenses, but also director tenure and diversity (which are becoming more significant investor considerations), director expertise and compensation structures. There is also no “one size fits all” approach to all activists. Many issuers have found certain activist shareholders to provide thoughtful and constructive input.

***Study possible arguments and be prepared to respond.*** It is essential that company management, boards and advisors thoughtfully consider possible areas of vulnerability before being approached by an activist. These potential vulnerabilities and arguments in favor of change should be a component of ongoing discussion with institutional investors. Companies should evaluate whether any actions that might be advocated should be implemented and, if not, develop a clear explanation for why doing so is not advisable. This process should be rigorous and fact-based and should seek to anticipate activist and investor counterarguments to the company’s position. The company should also consider proactively informing investors about its analysis of alternatives to create value, including previewing for investors why some superficially appealing actions are not advisable.

Materials (talking points, communications to shareholder, other investor or analyst presentations, etc.) should be prepared in advance of any approach that explains in clear language why pre-identified activists ideas are not advisable. Although the amount of effort devoted to preparation of materials may vary from company to company, once an activist gets traction with shareholders, it can be difficult to turn things around, so preemption, and, if preemption is not possible, speed of response, is essential.

***Prepare the board of directors.*** Management and advisors should keep the board apprised on possible activist approaches, intended company responses, views of significant investors, and current trends in activism generally and tactics in particular. Of most importance, a high level of board involvement and cohesion will be essential if an activist emerges, and the mechanics for that should be established in advance. Companies should also consider reviewing board policies to confirm that they suitably emphasize to directors their obligation to keep board discussions and other nonpublic information confidential, which will be important not only during an activist campaign, but also if an activist succeeds in getting one or more directors on the board.

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***Understand the consequences of the governance emphasis by institutional investors.*** Index funds are the ultimate long-term investors; as noted above, they have become increasingly influential and their obligation to their investors is to support an environment that creates the best chance to maximize, permanently, the overall value of public equities. These fund managers have decided that one method of maximizing value in an enduring way is to focus on the quality of corporate governance. The good news is that this gives public companies a path to obtaining the support of these funds and reduces the influence of proxy advisory firms. The bad news is that procuring this support can require significant adherence to a sort of “check the box” litany of governance initiatives, not all of which are appropriate or advisable for every company. But companies should focus carefully on these initiatives and their relationships overall with these investors, because the support of these investors often will be decisive in any activist campaign.

Institutional investors will be inclined to support boards and management teams that they believe are properly selected for their experiences, expertise, independence and diversity, have demonstrated an openness to shareholder engagement, and have demonstrated an appropriate level of oversight over corporate affairs, and, in the case of directors, of management and management compensation.

***Regularly review corporate bylaws.*** Corporate bylaws can establish some useful—and equitable—rules for the sorts of corporate actions sometimes initiated by activists, including calling special meetings of shareholders, acting by written consent, and nominating candidates for director. Market practices are continuously developing including, for example, the addition of new director qualifications, exclusive forum bylaws, and details of advance notice and proxy access provisions. On occasion, particular proxy contests highlight practical issues with bylaw provisions that can lead to drafting improvements. Every public company should regularly review its bylaws with its advisors and consider whether changes are appropriate. Bylaw changes are an area that requires judgment, and are clearly an area where one size does not fit all.

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