

SHAREHOLDER ACTIVISM BULLET REPORT



April 2016



Shareholder Activism Developments

- **DOJ Suit Against ValueAct Focuses on Violation of Premerger Notification Requirements.** The U.S. Department of Justice (DOJ) recently filed a suit in California federal court against VA Partners I, LLC, general partner to ValueAct Master Capital Fund, L.P. and ValueAct Co-Invest International, L.P. (collectively, ValueAct). The suit alleges that ValueAct failed to notify the government of its purchases of over \$2.5 billion worth of stock in Halliburton Co. (Halliburton) and Baker Hughes Inc. (Baker Hughes) in violation of the reporting and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act). In what could be a precedent-setting case, ValueAct has indicated it plans to contest the DOJ's position.

The HSR Act requires a premerger notification filing by an investor if, as a result of consummating a transaction, the investor will hold voting securities, non-corporate interests and/or assets of an issuer valued in excess of the notification threshold (\$78.2 million as of February 2016) and imposes an initial 30-day waiting period before the transaction may be consummated. The waiting period gives the Department of Justice (DOJ) and Federal Trade Commission (FTC) time to review the transaction, and in many instances also puts the issuer on notice that an investor might intend to increase its stake in the issuer and actively promote changes to the issuer's operations. The HSR Act provides an exemption (the investment-only exemption) from these reporting and waiting period requirements for acquisitions that would result in an investor holding 10% or less of an issuer's outstanding voting securities, but only if they are made "solely for the purpose of investment." Securities are held for investment purposes if the investor has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." Failure to comply with the HSR Act requirements can result in civil penalties of up to \$16,000 per day of noncompliance.

ValueAct acquired \$2.5 billion shares in Halliburton and Baker Hughes, two of the largest providers of oilfield products and services in the world, which had announced a potential merger in November 2014 worth approximately \$35 billion.

In its complaint, the DOJ alleges that ValueAct purchased stock in Halliburton and Baker Hughes with a view to learning information about the merger through access to management and influencing the

companies' business decisions during the course of the merger talks and beyond, and as a result could not rely on the investment-only exemption. The complaint notes a number of meetings between ValueAct and management of Halliburton and Baker Hughes, as well as memoranda circulated to ValueAct's investors stating that ValueAct's stake in Halliburton and Baker Hughes would enable it to "be a strong advocate for its deal to close," to support the DOJ's allegation that ValueAct built up its holdings in the companies to play an active role in the potential merger. ValueAct claims that it is the "most basic principles of shareholder rights" that entitle it to "[have] a relationship with company management, [conduct] due diligence on investments and [engage] in ordinary course communications with other shareholders" and that the DOJ's claim is without merit.

The DOJ is seeking a penalty of at least \$19 million and an injunction barring ValueAct from committing future violations of the HSR Act.

The DOJ and FTC have instituted enforcement actions against investors, narrowly construing the investment-only exemption, and the FTC's Premerger Notification Office has advised on specific scenarios through its informal guidance process. For instance, the FTC has suggested the following actions, among others, indicate activist intent that would not meet the investment-only exemption: (a) proposing corporate action and solicitation of proxies; (b) nominating a candidate for the board of directors of the issuer; or (c) serving as an officer or director of the issuer. In addition, the FTC has looked to communications by investors with the issuer, its shareholders and the public, and the filing of a Schedule 13D by an investor indicating that the investor might seek control of an issuer, among other things, to signal nonpassive intent in certain cases. The case could provide the first opportunity for a court to establish the scope of the investment-only exemption under the HSR Act.

- **Nasdaq Rule to Disclose "Golden Leashes" is Resubmitted.** Activist funds often offer to compensate their nominee directors in connection with their service as a director of the target corporation. This arrangement, known as a "golden leash," may involve a cash payment for agreeing to participate in the proxy contest and/or for succeeding in the contest as well as compensation paid directly by the

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Shareholder Activism Developments (continued)

fund that is tied to the future stock price performance of the target company over some time horizon. Currently, U.S. securities laws do not require the disclosure of (i) compensation agreements between a board nominee and the nominating shareholder, or (ii) conflicts of interest presented by compensation arrangements between a nominee and a nominating shareholder in contested proxy solicitations, making it difficult to determine the frequency with which hedge funds use golden leashes.

In January, Nasdaq proposed a rule that would require public disclosure of third-party compensation arrangements on company's websites, in their proxy statements or, if a company does not file proxy statements, on Form 10-K or 20-F. The rule proposal was rejected by the SEC on technical grounds but re-submitted by Nasdaq in March 2016. The re-proposed rule would exempt from disclosure compensation arrangements already otherwise disclosed or that relate only to reimbursement of expenses incurred in connection with the candidacy as director. Companies that fail to make the required disclosure would have to remedy that failure by promptly disclosing it by press release or SEC filing. Companies that are deemed to be deficient in reporting would have to provide a plan to regain compliance to Nasdaq. Failure to do so could lead to delisting. Nasdaq is also publicly soliciting comments from interested parties on the scope of the rule, including whether directors receiving third-party compensation for board service should not be deemed independent. A link to the questionnaire is [here](#).

The public comment period for the proposed rule expires April 26, 2016.

- **Delaware Court Applies Heightened Scrutiny Standard to Defensive Measures.** In late 2014, activist investor Barrington Capital ("Barrington") threatened a proxy contest to nominate and elect a number of Ebix, Inc ("Ebix") directors. Days later, Ebix prepared, and the board considered, a package of defense-related bylaw provisions—including provisions permitting the board to delay special shareholder meetings for up to 120 days and, under certain circumstances, to prevent the election of directors at special meetings. Soon thereafter, Ebix and Barrington entered into a director nomination settlement agreement under which Ebix agreed to nominate and support two Barrington nominees and Barrington agreed to standstill and voting provisions for a two-year period. After the parties had entered into the settlement agreement, the board adopted the bylaw amendments. Shareholders brought suit in the Delaware Court of Chancery, claiming that the directors had breached their fiduciary duties, on the basis that the bylaws, and also the settlement agreement (due to the standstill and voting provisions), were "entrenchment devices." See *In re Ebix, Inc. Shareholder Litigation* (Del. Ch. Jan. 15, 2016).

Delaware courts generally apply the heightened scrutiny standard prescribed by *Unocal v. Mesa Petroleum Co.* when reviewing challenged board actions taken in response to perceived threats to corporate control. Under *Unocal*, the Board has the burden of proving that it reasonably perceived a threat, and that its response was not preclusive, but reasonable in relation to the threat.

On a motion to dismiss the shareholders' complaint, the Chancery Court in *In re Ebix, Inc.* reviewed the defensive bylaw amendments under the *Unocal* test, but declined to review the settlement agreement under *Unocal*.

In denying the motion to dismiss, the court considered the bylaw amendments a defensive response subject to *Unocal's* heightened scrutiny because they (i) were first considered within days after an activist expressed its intention to launch a proxy contest and (ii) had clear defensive value. The court will apply the *Unocal* test even when, as in this case, the response is not to an immediate threat, but a potential future threat. Barrington was bound under the standstill and voting provisions at the time the Ebix board adopted the amendments, but the court found clear defensive value on the basis that the activist posed a potential future threat, as the standstill would expire in two years. Because under the settlement agreement the board agreed to surrender two board seats (and thus reduced its control), the court held that the settlement agreement was entitled to review under the business judgment rule standard.

In re Ebix, Inc. serves as a reminder that boards should consider the extent of the defensive aspects of a settlement agreement. The court viewed the defensive aspects of the agreement as ancillary to the essential nature of the agreement, choosing instead to see it as a relinquishment of control because it provided for the giving up of seats and the relinquishment of a degree of control to Barrington. As a result, the court chose not to apply the *Unocal* test to the settlement provisions. Boards should evaluate the extent of any defensive effects of a settlement agreement to ensure that restraints on potential control changes would not be regarded as the primary purpose of the agreement.

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