THE SHAREHOLDER SERVICE

OPTIMIZER

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EARLY RETURNS FROM THE ANNUAL MEETING FRONT: LOTS OF GOOD NEWS, BUT SOME BIG, BAD SURPRISES ARE STILL IN STORE FOR THE UNWARY

The big news from the Annual Meeting front in the early going is that says-on-pay are mostly sailing by nicely…And bigger news, perhaps; big companies have been ditching the three-year-say-when-on-pay recommendations that many of them planned to recommend…based on early returns that indicate a rapidly snowballing preference for annual “says” by institutional and individual investors alike…exactly as we had predicted.

In just one week in mid March, three Fortune-50 companies told us they were making last minute switches in their proxy statements – from the three-year says they initially intended to recommend to an annual say…And this seems to be fast percolating down to smaller companies too.

The irony here is that three-year says actually provide a much stronger governance structure, and a much deeper and broader framework for evaluating executive pay, we think – which requires a LOT more work on the part of corporate pay-crafters. Thus, we predict that those currently intractable institutional investors will wake up before the next vote on saying-frequency comes up and insist on a three-year say…if they are really smart, that is. “Think about it” we consoled the folks who felt sad that they had ‘retreated’ from the 3-year say; “With a 3-year say, you give all those Monday-morning-quarterbacks a three year look-back to second-guess…plus a 3-year look-*ahead* to evaluate and second-guess as well. Good for governance, yes…Good for YOU, if you have to craft and draft all this stuff? Probably not. And let’s note the way those one-year says are mostly sailing through when teed-up as ‘routine matters’ to be rubber-stamped like the ratification of auditors – and how this will soon give activists and other second-guessers some very compelling reasons to re-think, we predict.

But in a not so happy development, four companies have had voters say NO on pay so far – most recently the much picked-on Hewlett Packard – and

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CONSENT SOLICITATIONS

By Merrill Stone and Matthew Kane

Kelley Drye & Warren*

Back in 2000, we discussed in the *Optimizer* how would-be acquirers were increasingly using consent solicitations in attempts to ambush boards and to effect changes of control. Consent solicitations still hold a notable place in the corporate takeover landscape, even if they are perhaps not as widely publicized or notorious as they were a decade ago.

In the hostile takeover and unsolicited offer context, consent solicitations are most often employed to remove the target's directors who are opposed to the acquirer's advances and replace them with a handpicked slate of friendly candidates who support the merger or acquisition. We noted in 2000 that this practice would likely persist because launching a consent solicitation is relatively inexpensive compared to other options and directors remain easy targets for shareholder backlash, often acting as magnets for blame and accusations of self-interest.

Today, consent solicitation bids are often not carried out to fruition, but they are still alive and well as an important element of takeover strategy. Thus, companies and their directors should continue to think about them.

One reason that hostile consent solicitations were and still are viable options for many would-be acquirers is that Delaware law permits, as it did in 2000, any action that can be taken at an annual or special meeting of stockholders to be taken instead, without prior notice and without putting the matter to a formal vote, by the written consent of the minimum number of stockholders that would be necessary to act on the matter at a stockholder meeting at which all shares entitled to vote were present and voted. Nevada, also a popular choice as a state of incorporation, has substantively similar statutory provisions. Other states, however, have more restrictive rules and offer more protection to existing boards. California, for example, has a similar written consent statute to that of Delaware except that it has a specific carve out for the election of directors that requires the written consent of all of the holders of outstanding stock, not just the number that would be required to act at a meeting. Similarly, under New Jersey law, unless the certificate of incorporation provides for a more liberal standard, shareholders can not act by written consent in connection with the annual election of directors and in other contexts written consents must be signed by at least all shareholders entitled to vote. New York law also requires the consent of all stockholders entitled to vote for any actions taken outside of a meeting unless the certificate of incorporation permits the action to be taken by the minimum number of shareholders that would be necessary to act at a meeting at which all shares entitled to vote were present and voted. It is important to note that regardless of which "default" mechanism is contained in a state's statutes, a corporation may always restrict or eliminate the power of shareholders to act by written consent in its certificate of incorporation.

One of the most high profile hostile takeovers to employ a consent solicitation in recent years involved InBev's 2008 acquisition of Anheuser-Busch. For InBev, the consent solicitation was an element of a larger strategic plan to acquire Anheuser-Busch. InBev initially announced an unsolicited non-binding proposal for a friendly combination of the two beer makers, offering to acquire all outstanding Anheuser-Busch common shares for $65 per share, which was a 35% premium over the then current market value and an 18% premium over the all-time high. Two weeks later, the Anheuser-Busch board rejected the $65 per share offer but said it was open to higher-value offers. InBev immediately filed a lawsuit in Delaware seeking a declaratory judgment that a consent solicitation could remove all thirteen of the directors on the Anheuser-Busch board,[1] and launched the formal consent solicitation shortly thereafter. InBev used this vehicle to avoid the delay and cost of going hostile while still maintaining negotiating strength. The two companies restarted negotiations the next day and a deal was approved within a week. The consent solicitation threat proved so effective that InBev never actually had to follow through on the effort. The companies agreed on a price of $70 per share, and Anheuser-Busch became a wholly owned subsidiary of InBev.

There are several noteworthy lessons from the InBev/Anheuser-Busch story. Perhaps the most foreboding point is that while a consent solicitation can be costly and cumbersome, it has the potential to be such an effective tool that even threatening it in itself constitutes a strong bargaining chip. It is also important to note, however, that one of the reasons InBev was able to launch a fairly successful consent solicitation at all was that Anheuser-Busch did not have many of the standard take-over defense mechanisms in place to block such a move. Anheuser-Busch is a Delaware corporation and as such could have amended its certificate of incorporation to bar shareholders from acting by written consent altogether, but it did not. Anheuser-Busch also did not have different classes of stock, a staggered board, or a poison pill, all hallmarks of standard hostile takeover defense. Essentially, the St. Louis brewer made itself fairly easy prey for InBev.

Consent solicitations have also been used to defend against an unwanted transaction. Dynegy Inc. is a New York Stock Exchange-listed energy company that owns and operates power plants, provides wholesale power to utilities and municipalities and employs more than 1,800 people nationwide. In 2010, Carl Icahn, Dynegy's largest shareholder, helped Dynegy fend off a takeover bid by Blackstone Group. Following that successful defense, Icahn and the Dynegy board agreed on a deal for Icahn to acquire the company for $5.50 per share – fifty cents per share more than Blackstone offered. Dynegy's second largest shareholder, hedge fund Seneca Capital, publicly opposed the bid, arguing the price was inadequate and the company was really worth between

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[1] A recent amendment to Anheuser-Busch's bylaws left some doubt whether all of the board members could be removed in this fashion.

$7.50 - $8.50 per share. In an effort to fight Icahn's tender offer, Seneca also filed a preliminary consent solicitation statement with the Securities and Exchange Commission, seeking, among other things, to remove two directors from Dynegy's board and replace them with Seneca's handpicked candidates. Seneca planned to use its new board seats, along with the seats it already had, to take the corporation in a new direction, one that would better maximize shareholder value according to the hedge fund. Ten days after Seneca filed its preliminary consent solicitation statement, Dynegy issued a press release announcing that it was terminating its merger agreement with Icahn because the tender offer failed. The press release also announced that its Chairman of the Board had resigned and the rest of its directors would stand down at the next annual meeting and that the company had offered a director position to a Seneca-named nominee.

In a similar situation, earlier this year hedge fund Ramius LLC launched a consent solicitation to remove six independent directors of Zoran Corporation. Zoran Corporation is a semiconductor company that specializes in digital audio and video imaging applications with 1,550 employees and $357.3 million in revenue in 2010. Ramius, a holder of 7.3 percent of Zoran's stock, felt that Zoran was underperforming because of poor management, that there was untapped stockholder value and that the existing board did not serve the stockholders' best interests. The consent solicitation was successful and ousted the board chair and two other directors, replacing them with three Ramius candidates. The Zoran board had urged stockholders not to vote with Ramius, and even announced a merger with CSR plc, a British wireless technology company, that gave Zoran shareholders a 40 percent premium over the current share price. This, however, was still not enough to save the existing board. This dramatic example of shareholder activism underscores just how vulnerable a corporation can be to a shareholder consent solicitation.

These examples show how consent solicitations continue to play an active role in corporate takeovers, both to push bids forward and to block them. Even just launching a serious solicitation bid can be an effective negotiating tool. InBev secured its friendly acquisition just days after launching its consent solicitation. Seneca Capital's preliminary consent solicitation statement was similarly the last step in the hedge fund's successful campaign to force the Dynegy board to abandon the Icahn acquisition. Finally, Ramius forced a new merger, in addition to taking over Zoran's board, with its successful consent solicitation.

As noted in the InBev example, and as we said in our 2000 article, a hostile acquirer's ability to launch a consent solicitation depends on the laws of the state in which a corporation is organized. If a company is incorporated in Delaware or Nevada, or a state with a similar written consent statute, inserting a prohibition in the certificate of incorporation is the most effective way to insure that the company's board remains insulated from consent solicitations.

A certificate of incorporation, of course, cannot be amended without shareholder approval. While having to ask shareholders to enact provisions that limit their own rights could present risks from a shareholder relations perspective, according to published reports the majority of publicly held corporations formed in Delaware have such restrictions in their certificates of incorporation. Amending the certificate of incorporation to prevent shareholders from acting by written consent was our recommendation in 2000, and it remains the most surefire way to eliminate the risk of a hostile consent solicitation. Any board that considers this option should be aware, however, that the leading proxy advisors tend not to favor limiting shareholder power in this respect. Historically, Institutional Shareholder Services, Inc. ("ISS") effectively disapproved such measures across-the board. In its *2011 U.S. Proxy Voting Guidelines Summary*, however, while it continues generally to recommend that shareholders vote against such proposals, ISS has somewhat modified its position by stating:

> ISS acknowledges that a meaningful right to act by written consent is a fundamental shareholder right that enables shareholders to take action between annual meetings. However, the potential risk of abuse associated with the right that enables shareholders to take action by written consent such as bypassing procedural protections, particularly in a hostile situation, may outweigh its benefits to all shareholders in certain circumstances. Due to alternative mechanisms that have evolved for shareholders to express concern (e.g., a majority vote standard, the right to call a special meeting) and an evolving governance landscape, ISS will be taking a more holistic evaluation of a company's overall governance practices and takeover defense when evaluating these proposals.

Glass Lewis and Co. also stated in its *Proxy Paper Guidelines: 2011 Proxy Season* that while it is generally in favor of permitting shareholders to act by written consent, it suggests requiring a shareholder to own at least 15 percent of outstanding shares before it is eligible to launch a consent solicitation in order to prevent abuse and waste by small shareholders. The point for companies to bear in mind, however, is that ISS and Glass Lewis may well scrutinize proposals to restrict acting by written consent before issuing a recommendation.

If amending the certificate of incorporation is not practical or possible, our other previous recommendation for companies incorporated in Delaware or similar states was to consider reincorporating in another state with a more favorable set of laws. Reincorporation could present similar investor relations risks. ISS recommends a case-by-case evaluation for any reincorporation proposals with careful attention to management's reason for the reincorporation. Our final recommendation, from 2000 and now, is to do your homework on the rules governing your company. Check your state's laws to see whether unanimous shareholder consent is required to act without a meeting. Even if your company is incorporated in a state that requires the written consent of all shareholders to take action, review the corporation's certificate of incorporation and bylaws to confirm that no provisions in those documents modify the default laws in a manner that makes it easier for shareholders to act by written consent.

Finally, even if your corporation is protected against consent solicitations, directors should still be on guard against would-be acquirers trying to remove them. Hostile minority shareholders may still wage traditional proxy fights. Additionally, it is still too early to predict the extent to which the proxy access provisions of SEC Rule 14a-11, the effectiveness of which has been stayed pending resolution of legal challenges, will change the landscape if and when the rule begins to apply.