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**PROXY
CONTEST
COSTS**

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The cost of a proxy contest

Among the myriad complaints corporate America has against activist investors, the cost and distractions involved in proxy contests are first and foremost. Distraction is a hard factor to quantify, the costs involved in proxy contests less so—many S&P 500 companies disclose their extraordinary expenses in quarterly reports. Indeed, two recent bombshells have brought the issue into focus, with Sotheby's and Equity Commonwealth (formerly known as CommonWealth REIT), spending \$23.5 million and \$33 million respectively on contests where activists nonetheless achieved their objectives in full.

Activist Insight has combed through dozens of these reports going back to 2010 in order to get a better understanding of the real cost of proxy contests. The results may surprise even some veteran observers.

“ON AVERAGE, COMPANIES SPENT \$4.8 MILLION ON PROXY CONTESTS IN 2014, MAKING THIS YEAR NOTABLY MORE EXPENSIVE THAN 2013”

On average, US companies have spent \$4.8 million on proxy contests in 2014 so far, making this year notably more expensive than 2013. Of course, the outliers mentioned above had an impact; both involved considerable litigation and the activists were reimbursed (Third Point a reported \$10 million at Sotheby’s and Corvex and Related \$25 million at Equity Commonwealth). Yet 2013 was not without some expensive fights. Sandridge Energy’s proxy fight with TGP-Axon cost \$20.4 million, of which \$3.5 million was in reimbursements to the activist. Moreover, neither was within touching distance of the \$55 million incurred by Canadian Pacific Railway in its path-breaking proxy fight with Pershing Square Capital Management in 2012.

The cost to corporate America

In a recent column, The New York Times’ “Deal Professor” estimated the costs of gadfly investors, who make precatory proposals despite sometimes owning as little as \$2,000 of stock in large-cap companies, at \$87,000 per proposal. However, Michael Levin and Broc Romanek have suggested problems with this account; the figure is likely inflated, is based on estimates, and could be lessened by a presumption in favor of inclusion on proxy ballots.

Proxy contests raise some of the same questions, including whether shareholders should have alternative options on their ballots. Yet with more at stake, directors and management are keen to throw resources into re-election campaigns where there is an impending threat to their control of the company. To date, relatively little time has been spent discussing these expenditures. The cost of proxy

Fig 1: Proxy solicitation costs (\$)

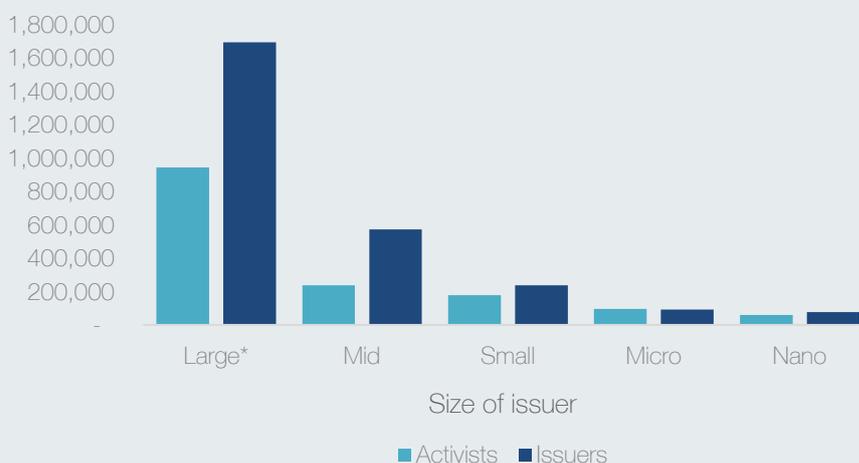
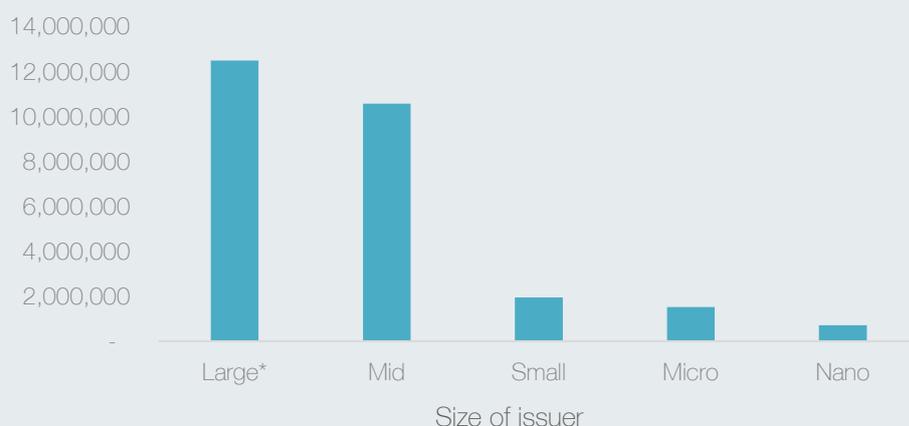


Fig 2: Corporate spending on proxy contests (\$)



All parties to a proxy solicitation are required to disclose the amount they expect to pay their proxy solicitors and the number of the solicitor’s employees who are likely to work on the campaign, often to the chagrin of the proxy solicitors themselves.

Figure 1 is based on data from almost 100 proxy statements and shows the gulf in spending between activists and corporations, a phenomenon which becomes more pronounced as the size of the company increases. Every so often, activists throw money at campaigns, such as when Carl Icahn said he would match the \$2.5 million spent by Dell on proxy solicitation fees during its LBO last year. Figure 2 is based on disclosures in annual and quarterly reports (sample size: 70). *In both cases, the limited number of large-cap contests means a small sample size.

contests does not figure highly in arguments against activism by high-profile figures like Martin Lipton, who prefer to focus instead on the long-term

consequences of activists’ supposedly “myopic” interests. Perhaps unsurprisingly, defense advisers have not created a fuss over their own fees.

As expected, the amounts spent by corporations defending themselves in proxy contests jump significantly with their size. Companies with a market-cap of between \$250 million and \$2 billion spent an average of \$1.9 million, while mid-cap companies (\$2-10 billion), spent \$10.6 million on average. New service companies focused on activist defense, such as Joele Frank or Camberview Partners, are typically added to the roster of law firms and proxy solicitors at the first sign of a proxy contest, driving up costs in comparison with standard annual meeting seasons.

Worth it?

For Paul Schulman, Executive Vice President of MacKenzie Partners, which offers proxy solicitation services to corporations and occasionally to activists, the cost of the process often has as much to do with the composition of the shareholder base as the size of the company. “You can use more people on a small fight with lots of retail shareholders, than on a big

one with mainly large institutions,” he says.

Yet big expenses can be keenly felt by corporations, and shareholders by extension; several million dollars can be the difference between profit and loss for small- or mid-cap companies.

“Big expenses can be keenly felt by corporations, and shareholders by extension”

ValueVision Media recently reported a quarterly loss following its proxy contest with Clinton Group, where the activist won four board seats. All told, the company spent \$5.3 million in vain, fighting the activist. Clinton Group spent \$800,000, according to its President, Greg Taxin.

“Ironically, companies may sometimes overspend and create a bit of a backlash,” says Bruce Goldfarb, the President and CEO of proxy solicitor

Okapi Partners, who points out that repeatedly receiving mailings from an underperforming management can be more irritating than persuasive.

Gary Lutin, who as Chairman of the Shareholder Forum seeks to resolve issues between corporations and their investors, says responsible leadership costs less than defense, and wins more support. “Defending irresponsibility requires a lot of effort,” he says, “but it will always be worth spending whatever amount of other peoples’ money is required.”

Activists do it on the cheap

Andy Freedman, a lawyer with Olshan Frome Wolosky’s activist practice, says the hedge funds he advises are less willing to incur large expenses and are typically outspent double-to-five times by their targets. “Our firms are, by nature, cost-conscious,” he says. “If they don’t get reimbursed, the costs come out of their return on investment.” Walking Activist Insight through the various stages of a proxy contest, he sets out how much an activist can expect to spend: \$50,000-100,000 if a settlement is reached early on in the process, around \$150,000 if the activist has to issue a preliminary or definitive proxy statement before it reaches a settlement.

Proxy solicitation services tend to be cheaper for activists, as figure 1 shows, at least partially because they drive tougher bargains than companies with large armories at their disposal. Yet printing and mailing, as well as rounds of telephone calls by proxy solicitors, all add to the costs. Okapi’s Goldfarb says activists can sometimes be more tactical than companies in their approach. “Companies have to reach out to a larger pool of shareholders,”

Outside of the United States

Recently activists have been looking beyond the US for targets, where there may be more low-hanging fruit. These don’t necessarily work out any cheaper, however, with additional costs usually incurred on top of an activist’s regular advisers. Andy Freedman, of Olshan FromeWolosky, says foreign jurisdictions like Canada can usually add 25% to the cost of a standard proxy contest. Jeff Eberwein, who recently fought a proxy contest at Australian-listed Antares Energy, says it could end up costing double his usual rate at somewhere between \$400-500,000. Some activists

also complain about service providers being considerably more expensive in Canada than in the US, due to lower levels of competition, and the greater likelihood of litigation driving up costs.

However, the UK may be one market where it is slightly cheaper to run a proxy fight, partly due to the company and the activist sharing a proxy form. Indeed, one mid-cap, FTSE 250 firm which fought a proxy battle in 2011 estimated its spending on legal advisers, proxy solicitation and brokerage at £400,000—a bargain by US standards.

“DEFENDING IRRESPONSIBILITY REQUIRES A LOT OF EFFORT, BUT IT WILL ALWAYS BE WORTH SPENDING ANY AMOUNT OF OTHER PEOPLE’S MONEY”

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average number of proxy solicitor employees used by activist in a fight

Case study - Aaron’s

Investors in the Atlanta, Georgia-based lend-lease retailer Aaron’s had a right to be disappointed with the firm’s second quarter this year. Despite rising revenues, Aaron’s profits were down \$25 million on last year, and more than half of that was spent fighting a proxy contest with its second-largest shareholder, Vintage Capital Management.

According to Aaron’s accounts, the \$1.9 billion market-cap company spent \$13.3 million in total on the challenge. Admittedly, the fight was an unusual one.

Vintage Capital made an unsolicited takeover offer (which it later withdrew), leading Aaron’s to hire both Blackstone and Goldman Sachs as advisers.

But if shareholders were hard-off following the deal, the cost of settling was low by comparison. Vintage Capital was reimbursed up to \$1.5 million and gained a seat on the board, while Aaron’s declassified its board and made special meeting requisitions easier.

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average number of proxy solicitor employees used by issuer in a fight

he says, noting that they are effectively mandated to offer all shareholders a vote. “Activists can be more selective.”

Thrifty activists can also do more in house, according to Lone Star Value Management’s Jeff Eberwein, including writing some elements of the proxy statement. In-house counsel, likely to be less busy than equivalents at a major corporation, can help cut costs. Some proxy firms also act in part on a performance basis. Using the same providers for repeat business tends to be cost-effective, while GAMCO can call on internal teams to solicit proxies, depending on the importance of the case. Outside public relations support is rarer, but not unknown in activist circles. Some law firms, like Olshan, offer internal PR services.

In a last-minute settlement like Starboard Value’s at Office Depot last year, practically the full costs will have been incurred by both parties. In that settlement, low-spending Starboard as granted up to \$800,000 in reimbursements, similar to the amount spent by Clinton Group at ValueVision.

It’s clear that activists rely on reimbursements to be able to deploy resources year-after-year. For some, this has led to much larger bills, including a reported \$2.5 million to Jason Ader in his proxy fight at International Game Technology and \$20 million to Pershing Square at Canadian Pacific. Other activists are reimbursed less than their full costs. Lone Star, whose founder Jeff Eberwein puts his average contest at \$150,000-250,000, received \$60,000 in reimbursements following his settlement with Callon Petroleum.

By far the most important decision for activists, however, is which target they go after. A soft target can lead to an early settlement, but losing a proxy contest usually leads only to costs the activist and its investors must bear. That logic can also embolden activists to press on with contests as the risks of defeat grow. According to Freedman, “As the stakes grow larger, activists put all their resources to work. If that means hiring world class advisers, that’s what they’re going to do.”