SULLIVAN & CROMWELL LLP

March 10, 2015

The Evolving Landscape of Shareholder Activism

Key Developments and Potential Actions

It is clear that shareholder activism continues to evolve, expand and increase in influence. There is a growing emphasis, in particular by large mutual funds and other institutional investors, on shareholder engagement and shareholder-friendly governance structures that, together with the increased activity of activist hedge funds and other "strategic" activist investors, make shareholder engagement and preparedness an essential focus for public companies and their boards.

Most recently, BlackRock Inc. and the Vanguard Group, the largest and third largest U.S. asset managers with more than $7 trillion in combined assets under management, have made public statements emphasizing that they are focused on corporate governance and board engagement. Vanguard recently sent a letter to many of its portfolio companies cautioning them 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 (as discussed further below) the importance of direct shareholder-director interactions. BlackRock recently updated its voting policies to make clear that they are more than just guides to how BlackRock votes – they represent "our expectations of boards of directors." The new policies continue an emphasis on direct interaction between investors and directors.

These sorts of statements by large institutions are becoming more common – TIAA-CREF has sent letters to many issuers advocating the adoption of proxy access provisions, and a number of the largest institutions last year signed a letter sent to numerous companies in support of the shareholder engagement principles embodied in the Shareholder-Director Exchange (SDX) Protocol. These

statements and advocacy efforts come amid continuing high level of shareholder activism at a wide range of large and small companies.

What all this means is that shareholder activism, in terms of corporate governance and shareholder relations, has become mainstream. What began as a targeted effort by a small number of governance activists, supported by some academics, clearly is now a broad movement that is redefining the relationship between public companies and their shareholders. We expect this evolution to continue and believe that companies and their boards of directors should recognize that historic shareholder relations models, as well as "traditional" approaches to responding to shareholder initiatives, may no longer be optimal.

Activism has been successful as an asset class, attracting over $200 billion in investor funds, much from pension funds and other institutional investors. There is an active debate about the long-term impact of activism, but there is no question that in recent years activists in many cases have achieved short-term excess positive returns, and that activist campaigns have regularly garnered the support of many traditionally more passive shareholders. As a result even the largest, most respected companies may be vulnerable.

Companies should take, and many are taking, these developments seriously. Both directors and executive officers are proactively considering possible activist initiatives and discussing them at board meetings. Companies are devoting greater effort to communications with shareholders and are beginning to arrange for direct communications between shareholders and outside directors; we expect this trend to continue. It appears that corporations and shareholders are feeling their way towards a new relationship with significantly more scope for engagement. This is a complex process that will take time and vary from company to company, and today we remain in transition.

Activists often benefit from underdeveloped lines of communication between corporations and their shareholders, particularly in times of crisis. Activists may also have benefited from a perceived general decrease in investor trust in the thoughtfulness and diligence of boards and managements following the financial crisis. Transitions are challenging, so what should a public company do to address the changing environment? Here are some observations:

1. There is no "one size fits all" approach to activism.

Corporations should recognize that every situation is different. Small differences in circumstances can lead to substantial differences in options available to optimize outcomes. Considerations may include, among others, size of equity capitalization, identity of shareholders, identity and track record of activist(s), nature and attractiveness of an activist proposal and the company's response to the proposal, total shareholder return of company in recent years, the media profile of the company and activist(s), and overall governance profile of company. The governance profile includes not only structural defenses, but also director tenure (which, regardless of its merits, is becoming a more significant investor consideration), director expertise and compensation structures.

2. Study possible activist lines of attack, consider proactive communication with shareholders and be prepared to respond and preemptively address activist arguments.

It is essential that managements, boards and advisors thoughtfully consider possible activist lines of attack before the attack surfaces. They 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 counter-arguments 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 explain 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.

3. Prepare the Board of Directors.

Managements and advisors should keep the board apprised on possible activist avenues of attack, intended company responses and current trends in activism generally and tactics in particular. Many companies are doing this to some extent today, but the process should become a regular part of the annual board calendar and be integrated with board discussions on strategic planning and capital allocation. If an activist emerges, a high level of board involvement and cohesion will be essential and the mechanics for that should be established in advance.

4. Understand the consequences of the governance emphasis by institutional investors.

Index funds are the ultimate long term investors; they own the market 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. Thus, index funds are showing a particular focus on how companies are governed.

These fund managers have decided that one way to maximize 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, which control an ever increasing proportion of the votes at public companies. It also reduces the influence of proxy advisory firms. The bad news is that procuring this support, at this point, 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 their support often will be decisive in any activist campaign. These fund managers will be inclined to support Boards and managements that they believe are properly selected for their experiences, expertise and independence, have demonstrated an openness to shareholder engagement, and demonstrated an appropriate level of oversight over corporate affairs, and, in the case of directors, of management and management compensation. This is also the basis on which increased director interaction with shareholders can be helpful to demonstrate the appropriate functioning of a particular board. We would expect over time the governance expectations will assume a less "check the box" and more nuanced approach, but for now they are relatively formalistic.

5. Consider appropriate structures for Board oversight of and involvement in shareholder engagement.

As noted above, the board should be kept apprised of shareholder outreach efforts, feedback from shareholders, and trends or developments regarding shareholder activism. The regularity

and format of these postings will vary from company to company, as will the formality of board structures and processes for overseeing these areas. The Vanguard letter referred to above, although acknowledging that there is no one-size-fits-all engagement strategy, suggests that the creation of a "Shareholder Liaison Committee" as a possible means to facilitate board-shareholder communication. In addition, the SDX letter referred to above, which was signed by a number of large institutions, advocates the creation of a formal shareholder engagement policy.

It is likely that many companies will determine that these sorts of formal measures are not necessary or appropriate. Even so, companies and boards should consider how best to effect the board's oversight of shareholder engagement, and where appropriate contribute to that engagement. Some companies may determine that, while a stand-alone Shareholder Liaison Committee is not necessary in their particular circumstances, the mandate of their governance committee could be formally expanded to cover oversight of shareholder engagement. Even if no formal changes are made, a company should take steps to make sure that regular postings and presentations on shareholder engagement matters are included on the agendas for the board or relevant committees.

As companies have expanded their shareholder engagement efforts, both within and outside of activist situations, a frequent topic of commentary has been the involvement of directors in meeting directly with shareholders. Practice has varied significantly, depending largely on the predilections of particular directors and the expressed interest of key shareholders in these meetings. To date, most companies have made these decisions in an *ad hoc* manner, and until recently overall direct board-shareholder discussions have been relatively unusual, outside of a takeover or other crisis situation. It is clear that director-shareholder engagement will be a continuing and increasing area of focus for shareholders. The Vanguard Letter and SDX Protocol stand as clear indications that institutional investors will press for communications that include outside directors.

It seems unlikely that director meetings will ever be the primary means for shareholders to interact with companies – given the oversight function of the board, directors cannot be expected to have the details as to business matters that shareholders generally wish to discuss. However, it may become more common for directors to meet with large shareholders to discuss matters that are within the directors' purview, including governance structures, executive compensation and to hear the shareholders' views directly on other topics.

Even if a company has not received shareholder requests for meetings with directors, the company should anticipate that such requests will be coming sooner rather than later. The first step is to discuss the concept with the board. Ultimately, the level of director-shareholder engagement, if any, will turn on the comfort level that the board members have with particular directors engaging directly with shareholders on particular topics. Generally speaking, Regulation FD or confidentiality concerns should not be a bar to shareholder engagement, because these meetings would not normally involve the disclosure of non-public information. Of course, appropriate steps should be taken (including director training, accompaniment by legal personnel and/or limitation of topics discussed) to help avoid missteps.

6. Carefully review corporate by-laws.

Corporate by-laws can establish some useful – and equitable – rules for the sorts of corporate actions sometimes initiated by activists, including calling special meetings of shareholders and nominating candidates for director. Every public company should carefully review its by-laws with its advisors and consider whether changes are appropriate. By-law changes are an area that requires judgment, and clearly an area where one size does not fit all. A by-law change that would pass unnoticed at some companies may be seen as inflammatory at others. Shareholders are increasingly sensitive to board actions, such as by-law changes, affecting shareholder rights without prior shareholder consultation. Specific areas to consider include how far in advance shareholders must give notice of an intention to make a proposal or nominate a director at an

annual meeting, what disclosure is required of director nominees, whether there should be qualification requirements – such as an absence of third party compensation for director service – for directors, whether the by-laws should establish an exclusive forum for shareholder class actions and whether a board by-law change should preemptively address proxy access.

This period of transition may be challenging for companies and those that advise them. Activists seem to be achieving more success than would appear to be warranted by the strength of their ideas or proposals for change. At the same time, funds and other institutional investors are becoming more active in how they reach out to and interact with their portfolio companies. This current reality means companies need to ask themselves what they can do differently to change the existing dynamic so that the better substantive, value creating position prevails. In addition to the concrete steps outlined above, companies also should consider the increasing concentration in public company share ownership, the incentives affecting the interests of these owners, especially the index investors, the demonstrated ineffectiveness of focusing the substantive debate primarily on "short-termism" and the reasons for activist success. This is a complex analysis and, in many cases, action will be necessary, but undertaking that analysis and making appropriate adjustments will make it easier to prevent and, if prevention fails, prevail against, an activist challenge.

* * *

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Stefanie S. Trilling (+1-212-558-4752; trillings@sullcrom.com) in our New York office.

CONTACTS

New York

Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Jay Clayton	+1-212-558-3445	claytonwj@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
Brian T. Frawley	+1-212-558-4983	frawleyb@sullcrom.com
Joseph B. Frumkin	+1-212-558-4101	frumkinj@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Brian E. Hamilton	+1-212-558-4801	hamiltonb@sullcrom.com
John L. Hardiman	+1-212-558-4070	hardimanj@sullcrom.com
Matthew G. Hurd	+1-212-558-3122	hurdm@sullcrom.com
Alexandra D. Korry	+1-212-558-4370	korrya@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
Duncan C. McCurrach	+1-212-558-4066	mccurrachd@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
James C. Morphy	+1-212-558-3988	morphyj@sullcrom.com
Keith A. Pagnani	+1-212-558-4397	pagnanik@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
George J. Sampas	+1-212-558-4945	sampasg@sullcrom.com

Melissa Sawyer	+1-212-558-4243	sawyerm@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
Alan J. Sinsheimer	+1-212-558-3738	sinsheimera@sullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@sullcrom.com
Washington, D.C.		
Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@sullcrom.com
Los Angeles		
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Rita-Anne O'Neill	+1-310-712-6698	oneillr@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
London		
Tim Emmerson	+44-20-7959-8595	emmersont@sullcrom.com
Richard C. Morrissey	+44-20-7959-8520	morrisseyr@sullcrom.com
Ben Perry	+44-20-7959-8477	perryb@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
Paris		
Olivier de Vilmorin	+33-1-7304-5895	devilmorino@sullcrom.com
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Carsten Berrar	+49-69-4272-5506	berrarc@sullcrom.com
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
York Schnorbus	+49-69-4272-5517	schnorbusy@sullcrom.com
Melbourne		
Robert Chu	+61-3-9635-1506	chur@sullcrom.com
Tokyo		
Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
William Y. Chua	+852-2826-8632	chuaw@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Kay Ian Ng	+852-2826-8601	ngki@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
Beijing		
Garth W. Bray	+86-10-5923-5958	brayg@sullcrom.com
Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com