

*Shareholder activism describes the efforts of a shareholder, or group of shareholders, who call for change in a company they deem undervalued in order to improve its bottom line. Against the backdrop of current market conditions, traditional activists have continued to voice their opinion to seek changes in strategy and management to unlock shareholder value. Recently, the market has seen new players join the activist arena, increased activist efforts into certain industries, a greater willingness on the part of corporations to concede board seats to avoid costly proxy battles, and an emphasis on alternative strategies to build a position in a target company.*

## How the Activist Landscape Has Been Impacted by the Credit Crunch

As the credit crisis has sent major financial stocks tumbling, many activists have seen an opportunity to take advantage of undervalued companies and/or shareholder discontent. The credit crisis has opened the door for two major types of activism in the financial sector. In the wake of massive sub-prime losses, credible and well-known shareholders are trying to maximize value of longstanding financial institutions and stabilize their operations. Secondly, socially responsible groups such as union representative CtW Investment Group, are attacking board members and executives they deem responsible for subprime failure. Both tactics are creating difficult times for executives and board members and are examples of an ever-changing activist landscape.

Two examples of activists attempting to shakeup major banks:

UBS	HSBC
<p><b>Olivant Advisers</b> co-founder and former UBS CEO, Luqman Arnold, has a 1.5% stake in the company, but his credibility and ability to influence shareholders far outweighs the power of his ownership.</p> <ul style="list-style-type: none"> <li>- Luqman proposed that the bank consider selling Pactual, its Brazilian wealth management business, as well as its Australasian business. He also urged the company to split off its investment bank operations.</li> <li>- CEO Marcel Rohner seemed to meet the activist shareholders halfway, scripting a plan to "slim down" the investment bank, resulting in significant job cuts.</li> <li>- Luqman leads a group of activist shareholders who unsuccessfully opposed the appointment of the bank's top lawyer, Peter Kurer, as the next Board Chairman, proposing that an experienced Swiss banker from outside UBS would be better suited to right the ship.</li> </ul>	<p>Hedge fund <b>Knight Vinke</b>, led by Eric Knight, urged HSBC to sell its troubled U.S. subprime lending business and warned of additional writedowns. The activist is accusing HSBC of not making an accurate value adjustment on its loans to customers and financial institutions, claiming that HSBC will write down an additional \$30B in the upcoming months.</p> <ul style="list-style-type: none"> <li>- Knight Vinke holds only 0.3% of the company, but has been vocal in its proposal for changes since last summer.</li> <li>- In late 2007, Knight voiced his concerns with executive compensation and promised to pursue a three-year campaign against the board, claiming to have received the support of dozens of investors.</li> <li>- At shareholder meeting on May 30, Knight was only able to gather roughly 19% (including abstentions) of votes against HSBC's executive compensation plan.</li> </ul>

## CtW Investment Group: Up & Coming Socially Responsible Group:

The CtW Investment Group, founded in February 2006, works with pension funds sponsored by unions affiliated with Change to Win to enhance long-term shareholder value through active ownership. Change to Win is a coalition of unions representing nearly 6 million members and about \$1.4 trillion in assets. The company supports regulatory and shareholder initiatives to ensure independent and accountable directors, reasonable executive compensation, and sound environmental, as well as other business policies.

Since its inception, the group has targeted corporate transactions to protect shareholders at companies like Rite Aid, Gold Kist, CVS/Caremark and LaFarge. CtW has also developed a Subprime Director Accountability plan to combat those they feel are responsible for the U.S. mortgage crisis. Their initial focus is on the six U.S. banks that suffered the largest losses: Washington Mutual, Merrill Lynch, Morgan Stanley, Bank of America, Citigroup and Wachovia. The group has targeted executives and board members whom they deem responsible for failing to control exposure to the mortgage crisis.

### Change to Win consists of 7 affiliated unions:

- Intl. Brotherhood of Teamsters
- Laborers' Intl. Union of North America
- Service Employees Intl. Union
- United Brotherhood of Carpenters
- United Food & Commercial Workers Intl. Union
- United Farm Workers of America

For More Information Contact:

Nicole Maselli  
Ipreo  
1359 Broadway  
2nd Floor  
NY, NY 10018  
(P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

June 2008

**Subprime Director Accountability Statement:** *“The board of directors at these firms bear ultimate responsibility. .... The banks’ board failures are especially egregious since it was apparent by mid-2005 that mortgage lenders were loosening lending standards and an overheated U.S housing market was at risk of collapse.”*

Two examples of CtW fighting for changes within its Subprime Director Accountability plan:

<u>Washington Mutual</u>	<u>Wachovia</u>
<p>CtW asked shareholders to oppose the re-election of two WaMu board members claiming that Mary Pugh (chair of WaMu’s finance committee) and James Stever (chair of its human resources committee) are responsible for the bank’s failure to recognize and respond in a timely manner to the housing bubble and its effects on shareholder value.</p> <ul style="list-style-type: none"> <li>- Mary Pugh resigned after winning barely 50% of the vote. Director Charles Lillis got 59% and James Stever got 58% of the vote. <i>“We believe (Lillis and Stever) also failed to win re-election”</i> if broker votes were excluded, CtW said in a press release.</li> <li>- CtW also publicly supported WaMu’s recent decision to the separate CEO and board chairman positions.</li> </ul>	<p>CtW called on Wachovia’s Board of Directors’ Risk Committee to describe what they did to protect shareholders from excessive exposure to mortgage-related risk over the past two years.</p> <ul style="list-style-type: none"> <li>- At the shareholder meeting, CtW was successful in getting Wachovia to name an independent Board Chairman. Ken Thompson held his Chief Executive position but is no longer head of the company’s board.</li> </ul>

Two examples of CtW’s success outside the financials sector:

<u>CVS</u>	<u>LaFarge</u>
<p>CtW opposed CVS’s proposed \$21B takeover of Caremark RX Inc. in October of 2006 due to concerns that the deal provided no premium to Caremark shareholders, yet guaranteed plum jobs, substantial personal windfalls and increased indemnification to Caremark insiders under investigation by the SEC and DOJ for possible stock options backdating.</p> <ul style="list-style-type: none"> <li>- CtW urged Caremark shareholders to vote against the proposed CVS merger and against the re-election of key board members.</li> <li>- CVS was ultimately forced to increase its bid by \$3.2B.</li> </ul>	<p>In February of 2006, Lafarge S.A. announced a \$75 per share offer for its subsidiary Lafarge N.A., the largest supplier of construction materials in North America. Funds sponsored by CtW affiliates believed the offer price was inadequate and that that board of Lafarge N.A. was not sufficiently independent of Lafarge S.A. to protect shareholders’ interests.</p> <ul style="list-style-type: none"> <li>- CtW communicated their concerns to the company, the SEC, and shareholders. Lafarge S.A. ultimately increased its offer to \$85.50 per share in order to consummate the tender offer.</li> </ul>

## Trends Favoring Activists

### Willingness of target companies to concede board seats:

A recent trend favoring activist shareholders is the increasing willingness of target companies to award board seats to activists in order to avoid a costly proxy battle. Referring to this trend, prominent activist Carl Icahn has stated: *“Over the years, it has become somewhat easier for me to get board seats without going through a proxy fight because the company realizes that I’m not going away.”* Motorola Inc. recently offered two seats to Icahn, who had demanded that the company spin off its struggling cell-phone division, in an effort to diffuse a proxy fight.

Several forces are behind the shift. Activists are more selective, seeking a handful of board seats instead of trying to oust a full board and focusing on battles they think they can win. They are also enhancing their credibility by nominating experienced, proven leaders for their slates. Icahn’s nominees for Motorola’s board include Icahn Partners fund manager and experienced investment professional Keith Meister, as well as veteran investment banker William R. Hambrecht.

For More  
Information  
Contact:

Nicole Maselli  
Ipreo  
1359 Broadway  
2<sup>nd</sup> Floor  
NY, NY 10018  
(P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

June 2008

However, the willingness of target companies to concede board seats means that board members who are part of the activist's slate may overextend themselves as they win seats at multiple firms. Activist nominees who sit on multiple boards may not have sufficient time to properly oversee the sophisticated operational and financial workings of the firms they are responsible for. Speaking on CNBC's *Closing Bell*, Icahn ironically stated: "How can a guy be on eight boards and know what the hell he's doing? These companies are complicated and you have tremendous competition from abroad. How can somebody sit on a board - even if he's the smartest guy in the world — if he was Einstein — and understand what that company is doing?" Motorola questioned Icahn's ability to juggle all of his board responsibilities as his number of seats continues to grow beyond the limit he stated.

As some activists have demanded seats on the board, often companies have had to expand their board to accommodate the request rather than replace existing board members:

Activist	Target Company	# of Seats Won	Status
Harbinger Capital and Firebrand Capital	The New York Times	2/2; board expanded from 13 to 15 members	Complete. The hedge funds acquired a 19% stake in the Times in late 2007, as it reeled from declining ad revenue, and disclosed their intention to push for board seats in January 2008. On 3/15/08, the Times expanded its 13-member board to 15 members, in order to include 2 Harbinger-Firebrand nominees, and avoid a protracted proxy battle.
Crescendo Partners	O'Charley's Inc.	3/4; board expanded from 9 to 12 members	Complete. In late 2007, Crescendo Partners acquired an 11% stake in O'Charley's requesting the company to consider selling some businesses. In order to ensure that its demands were met, Crescendo Partners demanded 4 of the board's 9 seats. In March 2008, instead of pursuing a proxy fight, O'Charley's awarded Crescendo Partners 3 seats as it expanded its board. O'Charley's directors felt that a proxy battle would be expensive and disruptive and were impressed by Crescendo's nominees, which included Douglas Benham, the former CEO of the Arby's restaurant chain.

### Change in Voting Rules:

One of the most powerful weapons available to activists is their command of the shareholder voting process. During 2008, the New York Stock Exchange is expected to eliminate the broker discretionary vote for the election of directors. If this occurs, the net effect will shift additional power to activists in director elections.

Currently, if a retail shareholder fails to vote their shares in director elections at NYSE-listed companies, brokers holding those shares (called broker non-votes) are generally empowered to vote them at their discretion because director elections are considered "routine matters" under Rule 452. Brokers typically vote these shares in line with management's recommendations. Recently, many companies have adopted the majority voting system, under which nominees are typically required to receive the affirmative vote of at least 50% of the votes cast in order to remain in office for another term. The combination of Rule 452 being changed so that director elections are no longer a "routine matter" and the use of a majority vote standard will give disgruntled investors a much better chance at launching successful "just vote no" campaigns to remove incumbent directors.

A recent scenario where the broker vote influenced the outcome of an activist play was the CtW Investment's Group's attempt to unseat Washington Mutual directors James Stever and Charles Lillis. CtW research director Richard Clayton commented: "The disputed re-election of directors James H. Stever and Charles Lillis may have resulted from the inclusion of these phantom votes. The board needs to disclose whether Stever and Lillis received a majority of votes cast by shareholders and to request the resignation of any director who did not."

For More  
Information  
Contact:

Nicole Maselli  
Ipreo  
1359 Broadway  
2<sup>nd</sup> Floor  
NY, NY 10018  
(P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

June 2008

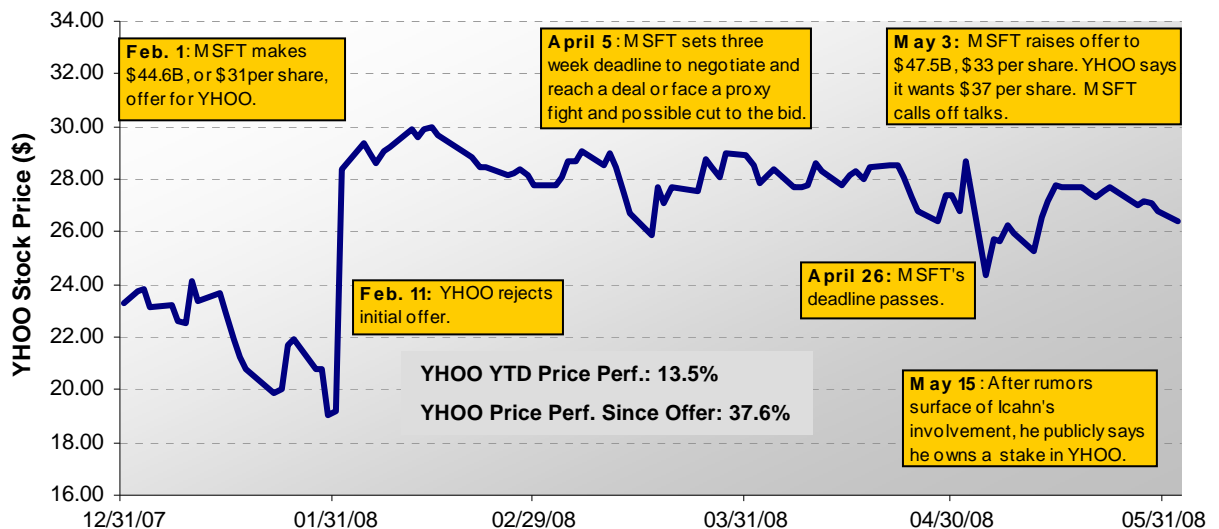
## Yahoo vs. Microsoft...vs. Carl Icahn

The Yahoo/Microsoft saga has undergone many twists and turns, none bigger than the involvement of Carl Icahn. Back in February, Microsoft's bid for Yahoo represented a healthy premium for the second place search engine; many investors, as well as Yahoo shareholders, eagerly anticipated Yahoo's acceptance of the merger. Yahoo initially rejected the offer and after about three months of back and forth Microsoft walked away from the table. Many shareholders were in disbelief. Eric Jackson, president of hedge fund Ironfire Capital, put together a group of alternative directors that would allow shareholders to oust the board from Yahoo's annual meeting in July. While only a small shareholder, Jackson knew he would have many disgruntled shareholders on his side.

On May 15th, rumors surfaced of Icahn's involvement in the increasingly vulnerable Yahoo; at the time, Icahn said he held a 4.3% stake in Yahoo, including 9.9 million shares and 49 million call options. The activist investor officially proposed a 10-member dissident board slate for the annual shareholder meeting originally scheduled for July 3<sup>rd</sup>. In anticipation of shareholder hostility, Yahoo postponed the meeting until late July. Icahn has since been given clearance to increase his stake in Yahoo from \$1B to \$2.5B. Documents were ordered unsealed on June 3<sup>rd</sup> during a shareholder lawsuit revealing that Yahoo had turned down a \$40 per share bid by Microsoft 15 months prior. This only further fueled shareholder discontent and Yahoo's susceptibility to activist shareholders, and added another chapter to the saga.

Since Icahn's activity, several other activists have stepped forward and shown their support for Icahn's campaign. It is said that legendary investor T. Boone Pickens and hedge fund Third Point Management, run by Daniel Loeb, have initiated/increased positions in YHOO.

### Yahoo! YTD Highlights



### History Repeating Itself?:

The Yahoo and Microsoft scenario is shaping up to be very similar to the acquisition of BEA Systems by Oracle in which Icahn played a pivotal role. In his battle with BEA Systems, Icahn was successful pushing its sale to Oracle for \$8.5B, or \$19.375 in cash for each BEA share, on January 16, 2008. This was after BEA rejected Oracle's bid of \$17 per share on October 12, 2007. BEA claimed the bid was too low, saying it will only agree to a \$21 per share bid. Oracle walked away from the offer and claimed it will not agree to a higher price. After the rejected offer, Icahn disclosed a public letter to the BEA's board of directors on October 26 asking for a public auction of the company and that the board allow the shareholders to vote whether to accept or reject the highest bid, threatening a proxy battle and lawsuit if BEA did not accept his requests. On January 16, 2008, after negotiations between Oracle and Icahn, Oracle came back with its higher bid which was accepted by BEA. On April 29, 2008, the acquisition was completed following approval from European regulators.

For More  
Information  
Contact:

Nicole Maselli  
Ipreo  
1359 Broadway  
2<sup>nd</sup> Floor  
NY, NY 10018  
(P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

June 2008

**Alternative Methods to Build Positions**

Increasingly, activists have been using alternative ways to build positions in target companies, two of which are through the use of options and equity swaps. Major players have been Pershing Square (William Ackman), Icahn Partners (Carl Icahn), Trian Fund Management (Nelson Peltz), The Children’s Investment Fund (Chris Hohn) and JANA Partners (Barry Rosenstein).

**Options Activity:**

Using options allows investors to build a position in a company without triggering the Federal Trade Commission’s Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976. It also allows investors to build positions in companies while using less capital. The HSR act calls for parties, who are planning to influence management or seek control, to file a “Notification and Report Form” with the FTC and the Assistant Attorney General once the value of their holdings reaches a dollar value, now set at \$63 million. At that point, the investor can no longer purchase further shares and must wait for clearance by the FTC. Triggering the HSR Act has many disadvantages for activist investors. First, awaiting FTC clearance can take up to 30 days, a time period in which the target company may take actions to help defend against potential activist plays. Second, since the requirement to file with the FTC is a dollar value, as opposed to a percentage of shares, larger cap companies find out if an activist investor is building stake before they reach the 5% threshold, which is when a 13D filing with the Securities and Exchange Commission is required.

The use of options to gain share positions was first seen in the 1980s by corporate raiders and met regulation challenges. In 1988, the Federal Trade Commission sued three clients of Bear Stearns Co. for using “matched” put and call options, drawing on a rule that does not allow transactions that are made in order to avoid reporting requirements. However, since 2006 investors have used options in their activist plays without running into regulatory opposition. Bruce Prager and Hanno Kaiser, a pair of antitrust attorneys, published an article in *The Deal Magazine* claiming that the FTC staff had changed its position on requiring immediate disclosure of matched options. The agency responded that it had always reviewed such transactions case-by-case and stated, “*Whether a particular transaction requires a filing will depend on the specific facts involved.*”

**Notable Examples:**

<b>Motorola</b>	<b>Heinz</b>
<p>In his activist play with Motorola, <b>Carl Icahn</b> was able to use less capital up front and delayed triggering the HSR act. On March 12, 2007 it was revealed that Icahn had bought \$184M of options for 35 million shares of Motorola Inc. between January 19 and January 31, 2007, representing a 1.4% stake in the company.</p> <ul style="list-style-type: none"> <li>- Motorola received a notice of an FTC filing at the end of February, but by this point it was reported Icahn was waging a proxy battle for board seats.</li> <li>- On March 26, 2008 Motorola agreed to spin-off its handset division.</li> <li>- In April 2008, Motorola entered into an agreement with Icahn in order to avoid a proxy fight, in which he was seeking four board seats. Under the terms, Icahn gained two seats on the Board, with Keith Meister serving immediately and William Hambrecht to be nominated for election at the 2008 annual shareholder’s meeting.</li> </ul>	<p>In a high profile battle with H.J. Heinz Co., <b>Nelson Peltz</b>, through Trian Fund Management and Sandell Asset Management, was successful in winning 2 board seats after seeking 5 members to the 12 member board.</p> <ul style="list-style-type: none"> <li>- On April 24, 2006 Trian had disclosed a 5.4% stake in the company, and revealed it had begun buying simultaneous put and call options on February 28, 2006.</li> <li>- Shareholders voted on the Trian nominees on August 16, 2006.</li> </ul>

For More Information Contact:  
 Nicole Maselli  
 Ipreo  
 1359 Broadway  
 2nd Floor  
 NY, NY 10018  
 (P)212.849.5100  
[Nicole.maselli@lpreo.com](mailto:Nicole.maselli@lpreo.com)

**Equity Swaps:**

Equity swaps are also an alternative strategy activists have been using to initiate or increase their stake in a target company. The derivative gives the investor an economic interest in the company, but does not entitle them the right to vote and does not allow the ability to sell the securities. Because of this difference, positions do not have to be reported to the SEC through a 13D filing once their stake reaches the 5% threshold.

In June, we could see a landmark case that would change the way activists must disclose their interest. The case is between CSX Corp. and The Children’s Investment Fund (TCI) run by Chris Hohn. TCI used equity swaps to launch a proxy battle on CSX with 3G Capital Partners. CSX has taken the case to court claiming TCI should have disclosed its interest in the company, claiming the equity swaps are just a circumvention of the 13D rule. U.S. District Judge Lewis Kaplan is expected to rule on the case by the end of June.

Additionally, JANA Partners used this strategy to build its stake in CNet Networks. JANA started to build its position in October 2007 believing the company was undervalued. Seeking to address CNet’s operating issues, JANA proposed two nominees for election to the board.

**Legacy Activism – A Blast from the Past**

While most target companies involved in activist plays are attacked by external entities such as hedge funds or wealthy individuals with large stakes, sometimes insiders such as the company’s founder, or former executives choose to take on the role of the activist. Legacy activists are usually individuals who, as former CEOs or senior executives, have stepped away from running the day-to-day operations of the firm, but continue to hold seats on the board, maintain stakes in the firm, or remain involved with the firm in an advisory capacity. In the cases profiled below, legacy activists have demanded accountability for poor stock performance, suggested spin-offs of under-performing units within a firm, as well as challenged strategic moves, such as mergers which they felt would be detrimental to the firm’s growth. Recent legacy plays include a campaign by Ezra Dabah, the former CEO of the Children’s Place Retail Stores, to buy the struggling chain. Additionally, a disclosure by the Estate of Craig H. Nielson, the founder of Ameristar Casinos, said that it was evaluating strategic alternatives including a merger, or a sale of all or part of Ameristar.

<u>Legacy Activist</u>	<u>Target Company</u>	<u>Status</u>
Maurice "Hank" Greenberg, former CEO (1967 - 2005)  Greenberg heads two firms: Starr International Co., an investment vehicle, and C.V. Starr & Co., an insurance brokerage. Both firms have holdings in AIG.	American International Group (AIG)	Pending. In November 2007, Maurice Greenberg, former CEO, stated in an amended 13D filing that he believes there are opportunities to significantly improve AIG’s performance. In March 2008, AIG filed suit against seven former company officials, including Greenberg, for allegedly misappropriating a \$20 billion block of company shares. Meanwhile, AIG, reeling from almost \$20 billion in write-downs related to bad bets on sub-prime mortgages, raised \$13.4 billion in equity on May 12.
The Hershey Trust  Founded in 1909, by company founder Milton Hershey, in order to administer a school for orphans. Milton Hershey later transferred his wealth, including his ownership stake in the company, to the Hershey Trust.	The Hershey Company (HSY)	Complete. In November 2007, the Hershey Trust became aggressive after concluding that Hershey CEO Richard Lenny had kept it in the dark about a potential deal with Cadbury Schweppes, and the company’s declining financial fortunes. The Hershey Trust asked six directors of the Hershey Company to resign; a total of eight directors resigned. The trust has a 31% stake in the company and is the leading shareholder. In April 2008, Richard Vowler, CEO and President of the Hershey Trust, announced that he was going to retire. Speculation regarding a Hershey-Cadbury Schweppes merger was reignited after Vowler’s departure.

For More Information Contact:

Nicole Maselli  
 Ipreo  
 1359 Broadway  
 2<sup>nd</sup> Floor  
 NY, NY 10018  
 (P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

June 2008

**Legacy Spotlight: Founder’s son challenges Hewlett-Packard & Compaq merger:**

One of the most high-profile legacy plays occurred in September 2001, when Hewlett-Packard and Compaq announce their merger agreement. All HP board members, with the exception of Walter B. Hewlett, son of HP co-founder William Hewlett, expressed support for the deal, which was strongly advocated by HP CEO Carly Fiorina. In March 2002, Walter Hewlett launched a proxy battle against the merger, which he eventually lost, and which led to his removal from the board. On May 3, 2002, the merger was completed.

### Conclusion: What's Ahead?

As we look towards the tail end of the proxy season and the latter half of 2008, shareholder activism in the marketplace will most likely have significant effects on many major companies around the globe, as well as their shareholders. Will the financial institutions stricken by the credit crisis see more shakeups? Will CtW's attack on bulge-bracket banks cause major changes in corporate governance? As laws change, what new trends will we see from shareholder activists? Will Yahoo be able to fend off both Microsoft and Icahn? As market conditions are perpetually changing, it is clear that activists, whether seeking their own profits or ethical agenda, will successfully adapt to an altering investor and regulatory landscape.

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For More  
Information  
Contact:

Nicole Maselli  
Ipreo  
1359 Broadway  
2<sup>nd</sup> Floor  
NY, NY 10018  
(P)212.849.5100  
[Nicole.maselli@ipreo.com](mailto:Nicole.maselli@ipreo.com)

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