Effectiveness of Hybrid Boards

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EFFECTIVENESS OF HYBRID BOARDS

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Executive Summary

This study examines whether "hybrid" boards – boards formed when activist shareholders such as hedge funds, through actual or threatened proxy contests, were able elect dissident directors but did not win full control of a board – create value for shareholders. The study reviewed the effectiveness of 120 such boards formed from 2005 through 2008. Board effectiveness was evaluated both in terms of changes in corporate governance structures and strategy, as well as through increases or decreases in shareholder value, measured in both absolute returns and relative to peers.

On average, the study found that total shareholder returns at ongoing companies with hybrid boards were 19.1% – 16.6 percentage points better than peers – from the beginning of the contest period through the hybrid board's one year anniversary. More than half of these gains came during a three-month period leading up to the formation of the hybrid board, providing strong evidence for a sizeable contest effect increase in share prices, as the market priced in its expectations of changes a hybrid board might bring. This effect is similar to the "announcement effect" – an increase in share price over a short period after the announcement, via a 13-D filing, that an activist investor has taken a significant position in a company's stock – observed in other studies of shareholder activism. In many cases, however, the contest effect was distinct from a 13-D announcement effect, as it often came a significant period time after the initial 13-D filing, and was clearly related to a specific activist initiative – the proxy contest – rather than a general expectation of productive activism.

Among the 15 ongoing businesses in the sample for which three years of performance data was available following the creation of a hybrid board, total shareholder returns averaged only 0.7% over the three-year period – 6.6 percentage points worse than peers. Total share price performance for the 39 months from the beginning of the contest period through the three year anniversary of the hybrid board, however, averaged 21.5% – 17.8 percentage points higher than peers – again largely on significant contest period share price appreciation.

While most of the companies in the study continued as ongoing businesses, 18 percent were sold during the study period and 5 percent entered bankruptcy. Among the companies that were sold, the sale price premium averaged 27.1% versus the undisturbed share price. For the companies going bankrupt, in all cases more than 99.9% of shareholder value was lost.

The performance results of the study may have been impacted by macroeconomic factors at work during the study period, particularly the dramatic fall in the stock market and credit crisis during 2008, the last year of the study period. It is plausible, for instance, that the type of situation that attracts activist investors to attempt to replace directors is heavily skewed toward companies perceived as undervalued – but that these situations also result in an inordinate number of "value traps" if economic conditions deteriorate significantly, because the companies involved tend to have weaker financial conditions and less financial flexibility and liquidity than the broader universe of companies overall.

Finally, the study found that it is no longer unusual for determined shareholder activists to obtain representation on the boards or targeted companies. In fact, during the four-year period covered by the study, dissidents were able to gain representation at approximately 75% of the companies targeted. In the majority of these cases, dissidents gained board seats through settlement agreements with companies, rather than a pursuing the contest to a shareholder vote.

Introduction

Shareholder activism is increasingly a fact of life for many corporate boards, due in part to newer market participants more culturally amenable to confrontation and in part to changes in the regulatory and shareholder environments which have reduced or eliminated certain obstacles to activism. In what activists (if not the managements they target) might consider a virtuous circle, success in highly visible campaigns – particularly those which meaningfully improved corporate accountability or demonstrably increased shareholder value – begets further acceptance of shareholder activism among the broader investor population, making support for additional activism more likely.

At the root of shareholder activism is the ability of shareholders to elect or depose a company's board of directors. The mechanism for replacing directors – the proxy contest – is still used relatively infrequently, but recent evidence suggests that the implied threat of such a contest now frequently achieves the same result: seating some or all of the dissident nominees (and/or mutually agreeable additional independent directors) on what becomes a hybrid dissident/incumbent board.[1] In just the past four years, the number of hybrid boards created annually as a result of real or threatened proxy contests at U.S. companies tracked by PROXY *Governance* rose from 18 in 2005 to 45 in 2008, an increase of 150%.

By contrast with the common perception that proxy contests are really driven by short-term, value extraction goals such as returning cash to shareholders or forcing a sale of the company, the reality is that hybrid boards are now more likely – in absolute terms and in comparison to hybrid boards in the past – to be overseeing an ongoing business than a sale of the company, a share buyback, or the issuance of a special dividend.

This study examines the effectiveness of hybrid boards created through real or threatened proxy contests at U.S. companies from 2005 through 2008, evaluating their ability to effectuate changes in governance and strategy (in comparison to the dissidents' explicit campaign agendas) and increases in shareholder value (measured both in absolute returns and in relation to peers).

History of Institutional Shareholder Activism

Increasing institutional ownership of public companies has been a sweeping trend in U.S. equity markets over the past half century. The U.S. Securities and Exchange Commission estimates that ownership of public companies by retail investors has declined from more than 90% in the 1950s to approximately 30% by 2009.[2]

The corresponding growth in ownership by institutional investors, from under 10% to more than 70% in half a century, has been compounded – from an assets-under-management perspective – by the enormous appreciation in total capitalization of the U.S. equity markets over the same period. Between December 1958, when it closed at 584, and December 2008, when it closed at 8,776, the Dow Jones Industrial Average grew by more than 1,400%. That increase, it might be pointed out, is net of the market's spectacular fall – amid the implosion of a subprime lending bubble, a subsequent credit crisis, and an ensuing recession – from its October 2007 high of 14,093. At that peak, the Dow had increased more than 2,300% from its 1958 close.

Academic studies generally agree that activism among institutional investors is a relatively recent phenomenon, and likely an indirect result of that enormous growth in institutional ownership. In 1999, three academics writing on corporate dividend policy could confidently open their study with the observation that "until recently, most institutional owners did not become directly engaged in corporate management decisions; rather, they were content to follow the 'Wall Street Rule' by selling their stock when dissatisfied with the firm's performance." As aggregate institutional assets under management grew, however, "the enormous level of assets controlled by institutions ma[de] efficient movement in and out of stock positions increasingly difficult. As a result, [institutional investors increasingly] have a tendency to become involved in corporate control when results do not live up to expectations."[3]

The effectiveness of that activism, however, is heatedly debated. One 1998 survey of corporate governance activity by institutional investors found that "a small number of American institutional investors, mostly public pension plans, spend a trivial amount of money on overt activism efforts," and that on the whole "institutions achieve the effects on firm performance that one might expect from this level of effort – namely, not much."[4] Part of this ineffectiveness was tactical – traditional institutional investors "don't conduct proxy fights, and don't try to elect their own candidates to the board of directors" – but much of it was likely structural: "legal rules, agency costs within the institutions, information costs, collective action problems, and limited institutional competence are all plausible partial explanations for this relative lack of activity." Another researcher concluded that institutional investors were discouraged from mounting proxy contests in particular due to inefficiencies in the system of proxy solicitation which "give management a vote-getting advantage," conflicts of interest with their own fiduciary interests (e.g. mutual funds which might sell their products to these same companies), and the generally seedy reputation of proxy fights in particular as a tactic for "'crank' bids, with no prospect for increasing share values."[5] Other research shows more favorable results related to shareholder activism on corporate governance. For instance, a series of studies dating back to 1994 conducted by Wilshire Associates for its client, the California Public Employees Retirement System (CalPERS), has found that companies named to CalPERS' annual governance "focus list" have outperformed their index over a subsequent five-year period. In the most recent update to its findings, Wilshire found that for the 134 companies targeted by CalPERS between 1987 and 2006, these firms outperformed their index by 15.7% over the subsequent five-year period.[6]

Other studies – which did not differentiate between institutional and non-institutional activists – indicate that certain tactics eschewed by most institutional investors were effective at value-extraction, but not necessarily at creating lasting strategic change or shareholder value within ongoing businesses. A 1983 study of proxy contests found that regardless of whether dissidents won seats on the board, "positive and statistically significant share price performance is associated with the contest." [7] Such gains often proved unsustainable, however, if the company continued as an ongoing business. A separate study of 60 proxy contests for board seats between 1978 and 1985, however, found that "less than one-fifth of the sample firms remain independent, publicly held corporations run by the same management team," because "contests are typically followed by managerial resignations, even when dissidents fail to obtain a majority of board seats, and are often followed by sale or liquidation of the firm."[8]

A later study of 270 proxy contests over the broader period from 1979 to 1994 concurred that proxy contests did increase shareholder value in aggregate, with "the bulk of the wealth gains stemming from firms that are acquired." [9] Among companies which were not acquired, it concluded, "the occurrence of management turnover has a significant, positive effect on shareholder wealth because firms replacing management are more likely to restructure following a contest." A fourth study found that 34% of companies targeted for proxy contests between 1983 and 1989 "experience[d] a change in top manager within two years following the contest," but that those changes were "concentrated among poorly performing firms in which outside blockholders acquire[d] an ownership stake," suggesting that "monitoring by active outside investors facilitates valuable internal control efforts."[10]

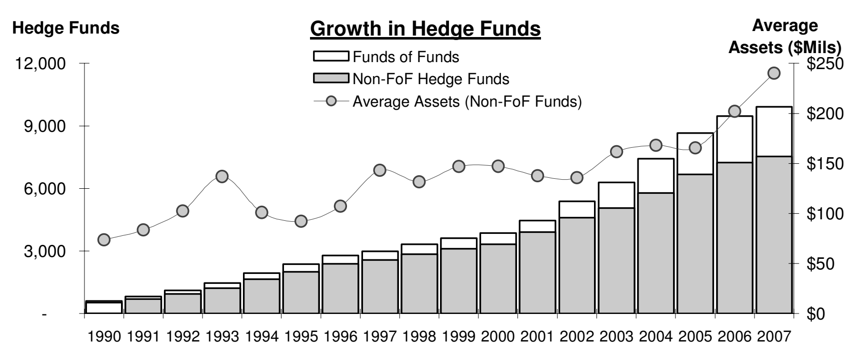
Recent regulatory changes, however – most notably "when [the SEC] stopped censoring most proxy material in 1992 and started allowing proxy 'free communication' in 2000"[11] – opened the door to a new era in institutional shareholder activism just as a new vehicle for institutional investment – the hedge fund – was coming into its own as a significant market presence. (The term "hedge fund" has become a catch-all for investment funds generally open only to qualified investors, which charge a performance fee, and which target absolute rather than relative return. While certain of the activist funds covered in this study specifically disclaim the label, we include them for classification purposes as they charge a performance fee, and are part of this tectonic shift in the landscape of investor activism.)

Hedge funds, one researcher has noted, "are not 'normal' institutional investors. They launch proxy fights for corporate control," giving them collectively an outsized reputation for aggressiveness and adding "considerable… *in terrorem* effect" to other, more incremental forms of activism.[12] Unlike certain traditional institutional investors, hedge funds often have no conflicts of interest which would deter them from overt or hostile activism. Hedge funds, not surprisingly, "have become critical players in both corporate governance and corporate control," honing an activism which is "strategic and ex ante (rather than intermittent and ex post)," and directing their efforts "at significant changes in individual companies (rather than small, systemic changes)."[13] The key development in hedge fund activism, one researcher concludes, may "be due to the fact that traditional institutions pursue a diversification strategy that is difficult to combine with strategic activism." A different, less nuanced, view is "that an almost unprincipled balance-of-power political model best explains the hedge fund activism phenomenon," but that from a broad shareholder perspective, "if these activities cause managements to review and reassess their strategies, corporate governance is improved."[14]

Despite the rapid growth in and activity of activist funds, however, some legal scholars argue that the paucity of proxy contests themselves demonstrates that the elemental power behind all shareholder activism – the ability of disgruntled shareholders to replace the board – "is largely a myth."[15] In practice, the right to elect corporate directors "is insufficient to secure the adoption of value-increasing governance arrangements that management disfavors." [16] What is required, they argue – in a model which echoes the demonstrated *in terrorem* authority of activist hedge funds generally – is "an alternative regime that would allow shareholders to initiate and adopt rules-of-the-game decisions to change the company's charter or state of incorporation," thereby "inducing management to act in shareholder interests without shareholders having to exercise their power to intervene." Using empirical studies of hedge fund activism since 2002, however, other legal researchers have concluded that hedge funds – unlike most other shareholder activists – have an enviable record of success in getting targets to accede to their demands, using the proxy system with remarkable, perhaps unprecedented, effectiveness. If the pattern of intervention persists in time, expands its reach, and maintains the present high level of governance success, then the separation of ownership and control becomes a less acute problem for corporate law.[17]

Rise of the Hedge Funds

Alfred Winslow Jones, a sociology graduate student turned *Fortune* magazine writer, is credited with founding the world's first "hedged fund" in 1949. Deploying a strategy based on his concept of 'velocity' – an early version of beta – Jones took long positions in stocks which appreciated more quickly than the overall market in periods of expansion, but depreciated more slowly in periods of contraction. Jones also took short positions in stocks with the opposite characteristics, so that the resulting portfolio was market neutral – in theory, it would make money whether the market went up or down. It was also by nature relatively constraining on the investment manager, as one writer has noted: "his system demanded humility – it meant admitting that he couldn't outsmart the market."[18]



Source: "Hedge Fund Activism: Findings and Recommendations for Corporations and Investors," The Conference Board, 2007.

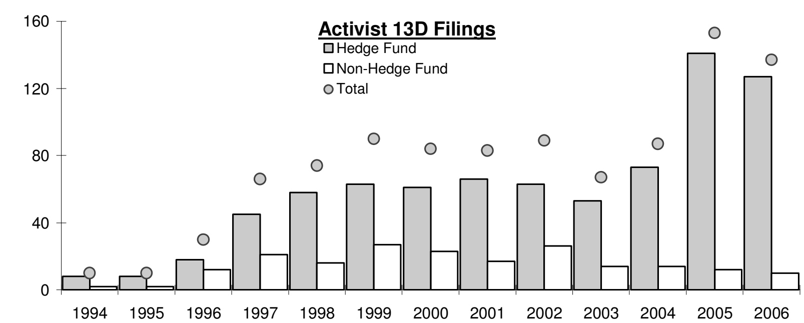
Since 1990 – when, the Conference Board estimates, a total of 610 hedge funds had an aggregate of $39 billion in assets under management – both the number of funds and the assets they represent have exploded to an estimated 9,917 funds managing $1.8 trillion in assets in 2007. Part of this growth is from the advent of "funds of funds" – hedge funds which invest in other hedge funds, rather than in the securities of publicly traded companies – which grew from just 80 in 1990 to 2,382 in 2007. Average assets among non-fund of funds hedge funds have more than tripled, even as the number of funds themselves increased, from $74 million in 1990 to $240 million in 2007.

At the same time, the investing strategies undergirding these funds multiplied wildly, so that the term "hedge fund" is now loosely applied to a wide range of investment management firms whose investment strategies range from proprietary quantitative models driving high trading volume to individual funds dedicated to a single stock, and may often contain no meaningful hedging (in the traditional sense) or market neutrality at all. Where Alfred Jones in 1949 was focused on beta, his hedge fund successors today, according to some observers, "are all about alpha, the singular pursuit of the above-market return, which is based on the conviction that you can, in fact, outsmart the market."[19]

Hedge Fund Activism

As demand – measured by both the number of hedge funds and their aggregate assets under management – has increased, however, the supply of opportunities to achieve above-market returns has not necessarily kept pace. As a result, one proxy solicitor noted in an advisory letter to corporate clients after the 2005 proxy season, "with so much money chasing similar investment opportunities, many hedge funds turn to activism to boost performance and enhance the payouts to the hedge fund's principals. …for anyone who hoped [the level of activist activity in] 2005 was an aberration we have bad news for you."[20]

In fact, a small but very visible minority of activist funds – whose own activism ranges from aggressive value extraction techniques to a private equity fund in which executives take a very hands-on approach to operations of target companies – are responsible for an enormous growth in institutional shareholder activism. Schedule 13-D filings grew from 10 filings in 1994 to 137 in 2006, an increase of more than 1,200%; within that trend, filings by non-hedge funds grew from 2 in 1994 to just 10 in 2006. Along with that increase in activism came an increase in investor credibility: "hedge funds today often are run by well-trained former investment bankers or research analysts… a notable change from the 'gadfly' activists of the past that often focused on corporate governance as an end unto itself."[21] Where formerly, dissident slates were often "a ragtag collection of co-workers and college buddies, hurriedly pressed into an alliance with a single, rich, combative investor"[22] they are now often impressively credentialed, the result of dissidents with strong capital markets experience recruiting unaffiliated nominees with equally strong management and operating experience.



Source: Schor, Michael and Greenwood, Robin Marc, "Investor Activism and Takeovers," available at http://ssrn.com/abstract=1003792.

There may be too little history yet to definitively categorize campaign strategies even within individual activist funds, but one proxy solicitor has identified three large groupings which seem to be emerging.

- ‘Alpha Activists’ are hedge funds genetically coded for confrontational activism, and generally “get into a stock with the planned intent of undertaking an activist’s approach to boost returns.”[23] For the purposes of this study, these activist funds have been divided into those funds which mount multiple solo contests within the study period, and funds which mounted only one solo contest.

- ‘One Timers’ are funds which “resort to activism only in instances when they believe it’s absolutely necessary to rescue an investment turned sour.” This group would naturally include funds operating under more of a private equity model, and are generally included in this study in the grouping of individual funds mounting only one solo contest.

- ‘Wolves’ include “the countless number of hedge funds who believe in the activist approach but will only move in as part of a pack when someone else takes the lead.” These funds may not formally become part of the group, for SEC reporting purposes, which comprises the dissidents in the contest; in instances where they do formally join the dissident group, they would be included in the study under the grouping of multiple funds mounting a single proxy contest.

Frequently, however, any of these funds might join part of the “wolf pack” of hedge funds which buy into a stock on the announcement of a proxy contest without taking any formal dissident role, and whose strategy – whether or not they are able to vote their shares – is to profit from the rise in share prices which often accompanies the contest period itself.

In their own way, activist hedge funds can be understood – as in fact, in the fight letters soliciting the support of other shareholders for their proxy contests, they often position themselves – as confrontational (if exasperated) value investors. They target companies, one proxy solicitor has noted, “where the stock price has underperformed its peers, is significantly below its perceived or actual value, and has otherwise not met shareholder expectations. This helps to explain why hedge funds don’t target overvalued companies or companies with generally poor prospects and no undervalued assets.”[24]

In general, early academic research suggests, hedge fund activism may be more likely to produce lasting improvements in shareholder value than institutional activists of an earlier era. Analyzing hedge fund activism from 2001 through 2005 – in which “most tactics are non-confrontational, and attain success or partial success in two-thirds of the cases” – one study found that the announcement of an activist initiative produced abnormal “announcement returns” in the range of 5-7 percent which were not reversed over the subsequent year. “This positive market reaction,” the study concluded, “does not reflect anticipated wealth transfers from creditors to shareholders, but instead reflects anticipated improvement in performance.”[25]

Evidence also suggests that activism by both hedge funds and “other private investors” in the current era is likely to generate significant positive increases in share prices around the announcement (13-D filing) date, and to generate “a further significant increase in share price for the subsequent year.” [26] The targeting and tactics of the two groups, though – and, ultimately, the nature of the structural change they introduce into targeted companies – diverges substantially. “Hedge funds target more profitable and healthy firms than other activists. Afterwards, hedge funds reduce the target's cash holdings by increasing its leverage and dividends paid. In contrast, other activists lower the target's capital expenditures and research and development costs.” [27]

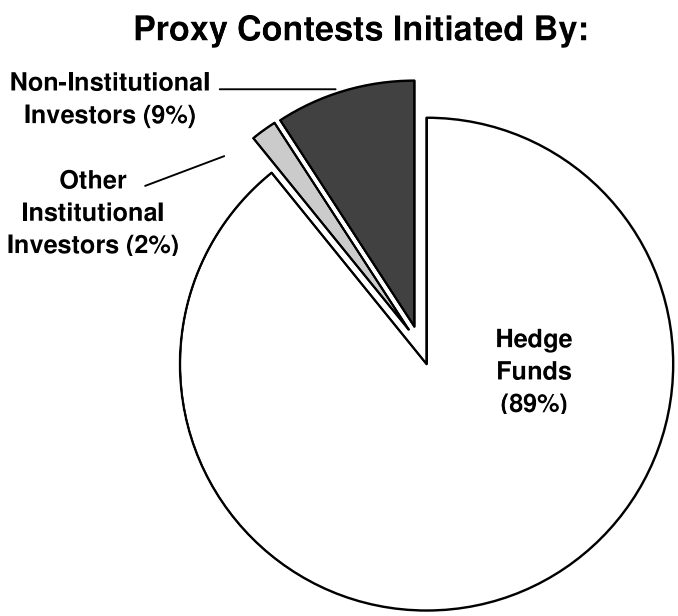
Surveying 130 instances of hedge fund activism between 2002 and 2006, however, another researcher concluded that:

> … hedge fund activism is a more benign phenomenon than its critics would have us believe. Hedge fund interventions neither amount to near-term hold ups nor revive the 1980s leveraged restructuring. Short term investments are rare. Large cash payouts have been made by only a minority of the firms surveyed, and borrowing has been the mode of finance in only a small minority of the payout cases.[28]

Proxy Contests, Dissident Directors and their Impacts

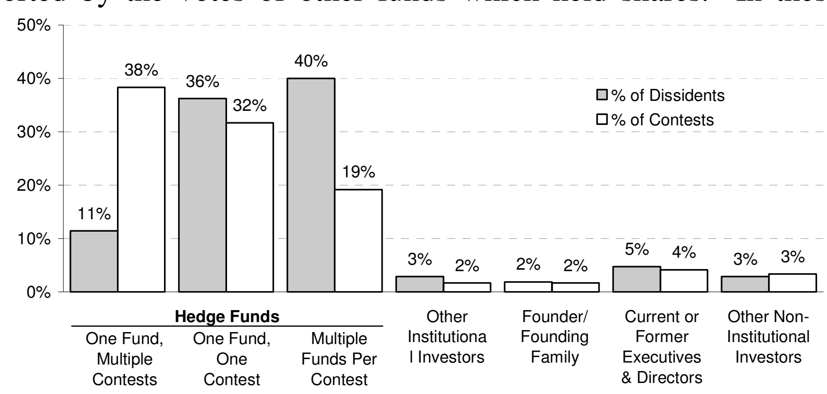
> *Hedge funds are to today's activism what junk bonds were in the 1980s, only more so. "The hedge funds, unlike a lot of mutual funds, are extremely performance-oriented," says [Carl] Icahn. "They're far more willing to vote against management."*[29]

Dissident Characteristics and Proxy Contest Outcomes



The resources required to mount a proxy contest – not merely the sizeable financial resources to fund filings, shareholder communications, professional advisory services, proxy solicitation and other activities of the contest, but also the often extensive analysis of and engagement with the company prior to any decision to pursue a contest, and the substantial time commitments from key participants throughout the campaign – effectively dictate that proxy contests are more likely to be led by institutional investors, who generally have greater resources to call upon. In the current sample of 120 proxy contests, threatened or pursued between 2005 and 2008, which resulted in hybrid boards, 91% were initiated by institutional investors.

Hedge funds, however, which initiated 89% of the contests, were by far the largest dissident type. Most frequently, a hedge fund was the sole official dissident in the campaign, even if supported by the votes of other funds which held shares. In these contests where a single fund was identified in SEC filings as the dissident, 12 funds representing just 11% of all dissidents in the study initiated 46 contests, or 38% of the study's total population, which resulted in hybrid



boards. Another 38 funds, representing 36% of all dissidents in the study, were identified as the sole dissident in SEC filings in one contest apiece, or 32% of all contests in the study. Twenty-three contests, or 19% of the study total, were led by multiple hedge funds acting as a group, as identified in SEC filings. The dissidents pursuing these contests included four of the funds which ran multiple solo contests as well as 42 additional hedge funds.

Other institutional investors, who collectively initiated 2% of contests leading to hybrid boards, included a private equity firm and a potential strategic acquirer. Non-institutional investors, who collectively initiated 9% of contests leading to hybrid boards, were a more polyglot group of founders, former and current executives and directors, and several other investors with no experience as company insiders.

In general, as Exhibit 1 indicates, the number of contests resulting in hybrid boards has grown substantially over the four years of the study period, increasing by 150% from 18 contests in 2005 to 45 contests in 2008.

Exhibit 1

Method of Resolution	Number of Contests					Percentage of Contests				
	2005	**2006**	**2007**	**2008**	**Total**	**2005**	**2006**	**2007**	**2008**	**Total**
Settlement	13	24	18	36	91	72 %	77 %	69 %	80 %	76 %
Shareholder vote	5	7	8	9	29	28 %	23 %	31 %	20 %	24 %
Total	18	31	26	45	120	100 %	100 %	100 %	100 %	100 %
Year-over-Year increase/(decrease)		72 %	(16)%	73 %						
Increase vs. 2005 totals		72 %	44 %	150 %						

More than three times as many contests which produced hybrid boards were resolved via settlements (76%) as were resolved via shareholder votes (24%). Other than a one-year decline in 2007, the percentage of contests which were resolved via settlement continued to grow from 2005, when 72% were settled, to 2008, when 80% were settled. Because the overall number of contests resulting in hybrid boards has grown so substantially over that period, however, the number of settlements in 2008 (36) was double the total number of contests in 2005 (18).

As Exhibit 2 indicates, on average over the study period, dissidents gained 2.0 seats on target company boards. This average fluctuated from 1.7 seats in 2005 up to a high of 2.3 seats in 2007 before falling back down to 1.8 seats in 2008. This represents, with some small volatility, about a quarter of the seats on the target board.

Exhibit 2

Board Changes	**2005**	**2006**	**2007**	**2008**	**Avg.**
Average Dissidents Seated	1.7	2.0	2.3	1.8	2.0
Average % of Board Seats*	25 %	25 %	29 %	23 %	25 %
Add'l Independent Directors Added					
Average Add'l Ind. Directors	1.4	1.4	1.8	1.2	1.4
Number of Affected Contests	7	7	5	12	8
Percentage of Total Contests	39 %	23 %	19 %	27 %	

* Not cumulative; represents only board seats gained in that year's contest.

The number of contests in which companies agreed to add additional independent directors grew by 58%, from 7 in 2005 to 12 in 2008; as a percentage of total contests, however, the incidence decreased from 39% in 2005 to 27% in 2008. Companies which were required to do so under their settlement agreements added an average of 1.4 additional independent directors.

The characteristics of contests and their resolution varied by category but also – particularly with dissidents who were not hedge funds – within categories.

Non-Institutional Investors

On average, non-institutional investors in the study were slightly more likely to settle a contest with the company as to pursue it to a shareholder vote: six of eleven hybrid boards created as a result of these contests were settled prior to a vote, and 5 went to a shareholder vote. As Exhibit 3 indicates, on average 2.2 dissident directors representing 30% of the board – were seated when a contest by a non-institutional investor was resolved via settlement, while 3.2 dissident directors, representing 44% of the board, were seated when a contest was resolved via shareholder vote.

Exhibit 3

Non-Institutional Investors

		Resolved via Settlement						Resolved via Shareholder Vote					
			Average						Average				
	Total Contests Resulting in Hybrid Boards	Settled Contests	Dissident Nominees	Dissidents Seated	Percent of Nominees	Percent of Board Seats	Add'l Independent Directors Added	Voted Contests	Dissident Nominees	Dissidents Seated	Percent of Nominees	Percent of Board Seats	Add'l Independent Directors Added
Founders (2)	2	1	4.0	-	0%	0%	2.0	1	2.0	1.0	50%	14%	-
Current Directors (1)	2	-						2	4.5	2.0	44%	24%	-
Former Execs/Directors (3)	3	1	7.0	3.0	43%	43%	-	2	5.0	4.0	80%	51%	-
Other Non-Institutional Investors (4)	4	4	4.3	2.5	59%	35%	0.3	-					
Total	11	6						5					
Weighted Average			4.7	2.2	46%	30%	0.5		4.2	2.6	62%	33%	-

Given the small number of contests and the diversity of dissidents and objectives, however, looking at simple averages for this group obscures the real story.

- The two founder-led contests were resolved via one settlement and one shareholder vote. Out of a total of six dissident nominees in these contests, however, only one was ever seated on the board. In the contest which was resolved via settlement, no dissident nominees were seated; the company instead agreed to add two additional, mutually-agreeable independent directors at a later date. Within six months of the settlement, before the additional directors were seated, that company announced it had agreed to be sold. [30]

- Of the two contests led by current directors, both were led by the same dissident director at the same company in different years, when his term was due to expire and the company declined to renominate him. Under the company's cumulative voting policy, that director's 16% of outstanding shares virtually guaranteed the election of at least one of his nominees. In each of 2005 – when he put forward a slate of three nominees – and 2008 – when he put forward a slate of six – he and one other dissident nominee were elected. Interestingly, this dissident initially became a director as part of a settlement agreement in a proxy contest, led by a hedge fund with which he was unaffiliated, in 1999. That hedge fund is no longer a significant shareholder.

- Former executives and directors both were more likely to pursue their contests through to a shareholder vote – only one of three contests was resolved via settlement – and on average seated a significantly higher percentage of their nominees, representing a significantly higher percentage of total board seats, than any of the other non-institutional investors.

- In the two such contests resolved via shareholder vote, an average of 4.0 nominees, representing 51% of the board and 80% of the dissident slate, were seated. In the single such contest resolved via settlement, 3 of 7 dissident nominees were seated, representing 43% of both the total board and the dissident slate. Unlike most other non-institutional investors in this group, former executives and directors – in fielding full slates of dissident nominees – were generally seeking a change in control more than influence.

- Four contests led by non-institutional investors who had never been company insiders were all resolved via settlements which, on average, seated 2.5 dissident nominees representing 59% of the dissident slate, and 35% of the board. These settlements also provided for seating an average of 0.3 additional independent directors.

Institutional Investors

Activist institutional investors effected at least some board change in 109 of 156 contests, or 70%, they mounted between 2005 and 2008. In those 109 contests where they were successful in effecting some board change, institutional investors were far more likely to resolve contests through settlements rather than shareholder votes. Including both individual activists acting alone, and activist groups, a total of 85 institutional-investor-led contests resulting in hybrid boards, or 78% of the total, were resolved via settlements.

For institutional investors acting alone, these settlements seated on average of 1.7 dissident nominees, representing 48% of the average dissident slate and 21% of the resulting board. These settlements also often required the company to add additional, mutually-agreeable independent directors; on average, hybrid boards created through a settlement with an institutional investor added an additional 0.4 independent directors to their boards. Among institutional activists acting as a group the numbers were similar: an average of 1.6 dissident nominees, representing 52% of the dissident slate and 20% of the resulting board, were seated, and an average of 0.6 additional independent directors were named to the board.

In the 20 contests - representing 23% of those led by institutional investors acting alone - which were resolved via shareholder vote, dissidents gained an average of 2.6 seats, representing 30% of the resulting board but 85% of the average dissident slate. In the four contests by activist investors acting as a group which were resolved via shareholder vote

– an admittedly small number from which to generalize – an average of 4 dissident nominees, representing 49% of the board and 93% of the dissident slate, were elected.

As Exhibit 4 indicates, there are significant differences in dissident and contest profiles among the institutional-investor-led contests.

Exhibit 4

Institutional Investors

		Resolved via Settlement						Resolved via Shareholder Vote					
			Average						Average				
	Total Contests Resulting in Hybrid Boards	Settled Contests	Dissident Nominees	Dissidents Seated	Percent of Nominees	Percent of Board Seats	Add'l Independent Directors Added	Voted Contests	Dissident Nominees	Dissidents Seated	Percent of Nominees	Percent of Board Seats	Add'l Independent Directors Added
Acting Alone													
Multiple Contests													
Steel Partners II LP	6	4	5.0	2.3	45%	37%	-	2	4.0	4.0	100%	52%	-
Icahn Partners LP	5	4	8.0	3.0	38%	26%	0.8	1	3.0	3.0	100%	43%	-
Ramius Capital Group LLC	5	3	2.0	1.0	50%	18%	0.3	2	2.0	1.5	75%	16%	-
Barington Capital Group	4	4	2.8	0.8	27%	12%	1.3	-					
Breeden Capital Management LLC	3	2	3.0	2.0	67%	18%	-	1	3.0	3.0	100%	30%	-
Relational Investors LLC	4	4	1.5	0.8	50%	11%	0.8	-					
Riley Investment Management LLC	4	4	2.8	1.8	64%	31%	0.5	-					
Third Point LLC	4	3	4.0	2.3	58%	25%	-	1	2.0	2.0	100%	22%	-
Costa Brava Partnership III LP	3	3	5.7	2.0	35%	25%	-	-					
MMI Investments LP	3	3	3.3	1.3	40%	11%	-	-					
Oliver Press Partners LLC	3	3	2.7	1.7	63%	23%	0.7	-					
Lawndale Capital Management LLC	2	2	4.0	2.0	50%	28%	-	-					
Subtotal	46	39						7					
Weighted Average			3.8	1.7	46%	22%	0.4		2.9	2.7	95%	33%	-
One Contest													
Other Hedge Funds (38)	38	27	3.0	1.6	52%	20%	0.4	11	3.1	2.4	76%	27%	-
Private Equity (2)	1	-						1	3.0	3.0	100%	38%	-
Potential Strategic Acquirers (1)	1	-						1	3.0	3.0	100%	33%	-
Total	86	66						20					
Weighted Average			3.5	1.7	48%	21%	0.4		3.0	2.6	85%	30%	-
Acting As a Group (46)*	23	19	3.1	1.6	52%	20%	0.6	4	4.3	4.0	94%	49%	-

**Includes four hedge funds identified above plus 42 additional institutional investors*

- Single Hedge Fund, Multiple Contests. Twelve hedge funds (listed individually in Exhibit 4) mounted a total of 46 separate contests in which they were the only dissident identified in SEC filings. Thirty-nine of these contests, or 85% of the total, were resolved via settlements; on average the dissidents gained 1.7 seats in each settlement, representing 22% of the resulting board and 46% of the dissident slate. These settlements also often included requirements that the company add additional independent directors, averaging 0.4 additional independent directors across all settled contests.

  The remaining seven contests mounted by these 12 funds which resulted in hybrid boards were resolved by a shareholder vote. In those contests dissidents received an average of 2.7 seats, representing 33% of the hybrid board but 95% of the dissident slate.

  While each of the twelve funds was more likely to resolve its contests via settlement than shareholder vote, certain funds characteristically garnered a significantly higher percentage of board seats despite the means by which the contest was resolved. Steel Partners, in the four of six contests in which it agreed to a settlement, averaged 37% of seats on the resulting hybrid board, which was more than half again the average for the group of hedge funds as a whole. By contrast, Barrington Capital Group, which settled in four contests, MMI Investments LP, which settled in three contests, and Relational Investors LLC, which settled in four contests, averaged only 12%, 11%, and 11% of seats, respectively, on the resulting hybrid boards.

Steel Partners II LP, Icahn Partners LP, and Breeden Capital Management LLC each gained a larger percentage of board seats when they prevailed in a shareholder vote than when they settled with the company. On average, Steel Partners took 52% of seats in its two contests which were resolved by shareholder vote, 15 percentage points higher than when it agreed to a settlement. Icahn Partners, which pursued only one contest to shareholder vote, received 43% of seats on the resulting board, 17 percentage points higher than the average of the four contests in which it settled. Breeden Capital Management also pursued only one contest to a shareholder vote, but received 30% of board seats in that contest, or 12 percentage points higher than the average for the two contests in which it agreed to a settlement.

In terms of nominee strategy, however, the three activist funds differed substantially. Each managed to seat 100% of its nominees in the contests which went to a shareholder vote; in the much larger pool of contests which were resolved via settlement, however, Breeden Capital Management seated 67% of its candidates, Steel Partners seated 45% of its candidates – effectively equal to the 46% average for this group of dissident funds – and Icahn Partners seated only 38% of its candidates, putting it in the bottom quartile of the group of 12 funds. While Breeden Capital Management and Steel Partners added no additional independent directors as part of their settlements, however, Icahn Partners added an average of 0.8 such directors per settlement.

- <u>Single Hedge Fund, Single Contest</u>. Thirty-eight funds mounted a single contest in which they were the only dissident identified in SEC filings. Seventy-one percent, or 27 of these 38 contests, were resolved via settlements in which an average of 1.6 dissidents, representing 20% of hybrid board seats and 52% of the dissident slate, were seated. On average, these settlements also added an average of 0.4 additional independent directors. In the 11 contests mounted by these funds which produced a hybrid board via shareholder vote, an average of 2.4 dissidents, representing 27% of board seats but 76% of the dissident slate, were seated.

- <u>Multiple Hedge Funds Acting As A Group</u>. Forty-six hedge funds, including four which also ran solo contests, together mounted 23 contests in which multiple funds were listed in SEC filings as members of a dissident group, and which resulted in hybrid boards. Nineteen of these contests, or 83%, were resolved via settlements in which, on average, 1.6 dissidents, representing 20% of the hybrid board and 52% of the dissident slate, were seated. Settlement terms also added an average of 0.6 additional independent directors, the highest average for any category of institutional investor. In the four contests which created hybrid boards through a shareholder vote, an average of 4.0 dissidents, representing 49% of the hybrid board and 94% of the dissident slate, were seated.

- Other Institutional Investors. The study included one proxy contest mounted by private equity firms whose buyout offer had recently been declined, and a second contest mounted by a potential strategic buyer seeking to force a sale. Perhaps not surprisingly, neither of the contests was settled prior to a shareholder vote. The company targeted by the private equity firms remains publicly traded, but 3 of its present 8 directors, or 38% of the hybrid board (and 100% of the dissident slate), were dissident nominees. The other company targeted by the potential strategic buyer has since been sold to a different strategic acquirer; in the shareholder vote, the full slate of three dissidents, representing 33% of the hybrid board, was elected.

Corporate Change Effected by Hybrid Boards

Despite the widespread impression that hedge funds employ proxy contests to pursue only value-extracting, short term financial objectives, dissidents in the study's 120 contests – which are predominantly hedge funds – articulated an array of objectives they believed the current board unwilling or unable to achieve. As Exhibit 5 indicates, moreover, dissidents have increasingly cited multiple objectives to support their campaigns.

Exhibit 5

Explicit Dissident Objectives

	Number of Contests*					Percentage of Affected Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
Performance Improvements	5	15	16	28	64	28 %	48 %	62 %	62 %	53 %
Governance Changes	6	16	10	11	43	33 %	52 %	38 %	24 %	36 %
Strategic Changes, excluding sale	5	1	10	22	38	28 %	3 %	38 %	49 %	32 %
Sale of Company	4	12	8	18	42	22 %	39 %	31 %	40 %	35 %
Other	2	3	9	16	30	11 %	10 %	35 %	36 %	25 %

* Not cumulative within a calendar year.

The need to improve corporate performance is the objective which has shown the most sustained growth on dissident agendas over the period, rising from citations in only 28% of 2005 contests to 62% of 2008 contests. Similarly, though less dramatically, the desire to pursue other strategic changes – including divestitures, restructurings, share buybacks, and special dividends, for example, but excluding sale of the company – has grown from being an objective in 28% of 2005 contests to 49% of 2008 contests. Pursuing a sale of the company, surprisingly, ranks relatively low on the explicit agenda, though it too has been increasingly cited as a dissident objective, up from 22% of 2005 contests to 40% of 2008 contests. Dissidents have also increasingly cited objectives not easily categorized, such as one 2008 contest devoted nearly exclusively to the objective of improving communications and transparency with shareholders; collectively, citations of these less-easily categorized objectives have increased from just 11% of 2005 contests to 36% of 2008 contests.

Dissident campaigns built at least in part on arguments for governance change, by sharp contrast, appear to have declined in relative importance over the period, at least as measured by the percentage of contests in which they are explicitly invoked as a dissident objective. After being cited in 33% of 2005 contests, governance changes were cited as a dissident objective in 52% of 2006 contests, before falling to 38% in 2007 and 24% in 2008. In absolute terms, however, because the total number of contests resulting in hybrid boards has grown so substantially from 2005 to 2008, governance issues were cited in nearly twice as many 2008 contests (11) as in 2005 contests (6).

Management Changes

Performance improvement, and to some extent strategic and governance changes, often imply a need for leadership change either in the executive suite or on the board itself. Dissidents were more reticent to make regime change a major rallying cry, however, perhaps for tactical reasons.

Nonetheless, as Exhibit 6 indicates, nearly half (49%) of the hybrid boards had replaced their CEO at least once by the end of the study period, and one in five (21%) had changed their chairman. This CEO replacement rate was similar to the overall CEO replacement rate among 2,500 North American firms studied by Booz & Company during the same period. As nearly two-thirds of those CEO departures were either planned retirements or the consequence of a firm being acquired, however, a more relevant comparison might be the turnover rate due to dismissals, which approached 15% over the same period and increased in each year of the study period. "In 2007," noted Booz, "the global rate of CEO dismissals due to poor performance or to boardroom disagreements was 4.2 percent. This is well above the rates we observed in the 1990s, but near the average for this decade"[31]

Exhibit 6

Management Changes

						Percentage of Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
CEO Left Company	10	22	11	16	59	56 %	71 %	42 %	36 %	49 %
Chairman Replaced	4	8	9	4	25	22 %	26 %	35 %	9 %	21 %

Some of this turnover among companies with hybrid boards – particularly for those whose proxy contest was resolved more than three years ago – is undoubtedly due to natural attrition. Thirty-six percent of companies whose hybrid board was created in 2008, however, have already replaced their CEO, as have 42% of hybrid boards created in 2007.

The average turnover for board chairmen, moreover, appears to be artificially suppressed by the relatively short period of time since those contests were resolved. Chairmen have been replaced at 9% of companies which had a contest in 2008, versus 22%, 26%, and 35% of companies with contests in 2005, 2006, and 2007, respectively.

Governance Changes

While the percentage of contests which cited the need for governance changes declined from 33% in 2005 to 24% in 2008, the evidence indicates that 43% of companies with hybrid boards have implemented governance changes. Moreover, even among hybrid boards created in 2008, when only 24% of dissidents explicitly cited a need for governance changes, 36% of boards have implemented changes.

As Exhibit 7 illustrates, the most numerous changes were board declassification and changes to the size of the board itself.

Exhibit 7

Governance Changes*

	Number of Companies					Percentage of Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
Board Declassified	3	6	4	2	15	17 %	19 %	15 %	4 %	13 %
Board Size Changed	-	2	8	6	16	0 %	6 %	31 %	13 %	13 %
Chair/CEO Roles Split	2	3	3	1	9	11 %	10 %	12 %	2 %	8 %
Majority Voting Instituted	-	4	2	1	7	0 %	13 %	8 %	2 %	6 %
Poison Pill Eliminated	-	2	3	2	7	0 %	6 %	12 %	4 %	6 %
Ind. Director Req. Increased	2	1	1	-	4	11 %	3 %	4 %	0 %	3 %
Other Governance Changes	3	-	4	9	16	17 %	0 %	15 %	20 %	13 %

* Company counts not cumulative within a calendar year.

Declassification has declined from 17% of hybrid boards created in 2005 to 4% of hybrid boards created in 2008, perhaps reflecting the reality that many potential targets have already declassified their boards: data gathered by PROXY Governance shows that the percentage of S&P 500 firms with classified boards declined between 2006 and 2008 from 49% to 41%. No hybrid boards created in 2005 amended their board size, whereas 6% of hybrid boards created in 2006, 31% of those created in 2007, and 13% of those created in 2008 have since amended their size. Three-fifths of the boards which amended their size (10 of 16) increased the number of directors to accommodate at least some of the dissident directors added as part of a settlement. (Increasing the board to accommodate directors added as part of a settlement, however, remained relatively uncommon: these 10 boards represented only 11% of the 91 hybrid boards in the study which were formed via settlements).

Ten to 12% of boards created in each of 2005, 2006 and 2007 have split the roles of Chairman and CEO, though through January 2009 only 2% of 2008 hybrid boards in the study had adopted that change. PROXY Governance data shows that across all companies in the Russell 300 index, the separation of roles progressed more slowly: while 47% of Russell 3000 companies had separate Chairmen and CEO's in 2006, that number had risen to only 51% in 2008. (Among S&P 500 firms the same trend was visible, but the percentages were lower: 34% of S&P 500 firms had separate Chairmen and CEO's in 2006, a number which grew only to 37% by 2008). Majority voting has been implemented, and poison pills either eliminated or allowed to expire, by 6% hybrid boards, predominantly those created in 2006 and 2007. For poison pill expirations, however, this may only reflect the larger trend among all U.S. companies to withdraw their pills or let them expire: in 2002, 60% of U.S. firms had a pill in place, but by 2008 that percentage had fallen to 24%.[32]

It is likely that certain governance changes – such as the aforementioned desire to improve a company's transparency in its communications with shareholders – would not require changes to a company's bylaws or charter, and thus would not be reflected in a simple tabulation of such changes. Dissident campaigns citing a need for governance reform, however, often cited changes, such as declassification of the board or separation of the roles of Chairman and CEO, which would be observable in corporate filings.

Using that methodology, and assuming such dissidents were not mistaken about the need for governance changes at their target companies, it appears that enthusiasm for such changes – as Exhibit 8 indicates – runs only slightly deeper among the hybrid boards which seated those dissidents who had expressed such desires upon commencement of the proxy contest than among the remainder of hybrid boards.

Exhibit 8

Outcomes when governance changes were:

	Number of Companies					Percentage of Affected Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
A dissident objective	6	16	10	11	43					
Governance changes implemented:										
One	2	6	3	3	14					33 %
Two	1	1	1	1	4					9 %
Three	1	1	2	-	4					9 %
Four or More	-	-	1	-	1					2 %
	4	8	7	4	23	67 %	50 %	70 %	36 %	53 %
None	2	8	3	7	20	33 %	50 %	30 %	64 %	47 %
Not cited by dissidents	14	15	18	35	82					
Governance changes implemented:										
One	3	3	5	12	23					28 %
Two	-	2	2	2	6					7 %
Three or More	2	-	2	1	5					6 %
	5	5	9	15	34	36 %	33 %	50 %	43 %	41 %
None	9	10	9	20	48	64 %	67 %	50 %	57 %	59 %

Of those hybrid boards whose dissidents cited governance concerns as part of their proxy campaign, 20 (47%) had announced or implemented no governance changes through January 2009. Fourteen of this group of companies (33%) made one change, 4 each (18% in total) made either two or three changes, and only one board (2%) made four or more changes.

By contrast, among all other hybrid boards, 34 – a smaller percentage of those boards, but a larger number in absolute terms – had announced or implemented at least one governance change by January 2009.

Strategic Changes (Other Than a Sale)

As an item on the dissident agenda, strategic changes – broadly understood to include changes in business strategy, operating structure, or initiatives short of the sale of the company which return value to shareholders – have nearly doubled in frequency from 2005 (28% of contests) to 2008 (49% of contests), even as the number of contests itself has more than doubled.

To some extent these objectives are themselves concrete plans which support a larger objective to improve corporate operating performance and, as such, may take some time to bear fruit. As Exhibit 9 indicates, for example, only 19% percent of hybrid boards have announced or implemented a spinoff or divestiture through January 2009. That average is undoubtedly weighed down by an 11% average among companies with a 2008 proxy contest however – a rate which, bucking the clear trend, is only two-thirds the 2005 rate, less than half the 2006 rate, and barely a third the 2007 rate.

Exhibit 9

Strategic Changes (Other Than A Sale)*	Number of Companies					Percentage of Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
Business/Operating Structure										
Major Restructuring/Cost Reduction	-	3	5	7	15	0 %	10 %	19 %	16 %	13 %
Spinoff or Divestiture	3	7	8	5	23	17 %	23 %	31 %	11 %	19 %
Acquisition	2	1	3	1	7	11 %	3 %	12 %	2 %	6 %
Unlock Value										
Initiate/Increase Share Buyback	3	9	10	5	27	17 %	29 %	38 %	11 %	23 %
Special Dividend	-	-	1	1	2	0 %	0 %	4 %	2 %	2 %
Other										
Bankruptcy Filing**	1	3	1	1	6	6 %	10 %	4 %	2 %	5 %
Delisted	3	1	2	1	7	17 %	3 %	8 %	2 %	6 %

* Company counts not cumulative within a calendar year.
**Includes one company which has since been sold

The 2008 data may reflect the simple fact that divestitures and spinoffs are not ordinarily overnight affairs, and certain 2008 boards may in fact be actively engaged in preparing a spinoff of or seeking a buyer for certain lines of business.

Other strategic actions, which can be announced in advance of the long process of making them a reality, reflect a more complete trend. Through January 2009, 13% of companies had announced or implemented such strategic actions as restructurings or major cost reduction initiatives, increasing from 0% among 2005 hybrid boards to 19% and 16% for 2007 and 2008 hybrid boards, respectively.

Certain other actions designed to return value to shareholders, such as initiating or increasing a share buyback, had increased in frequency from 17% of 2005 hybrid boards to 38% of 2007 hybrid boards. The sharp year-over-year decline of 27 percentage points in 2008 to 11%, however, almost certainly reflects the influence of larger macroeconomic factors, such as the credit crisis and recession in the U.S., which were already looming even as these hybrid boards were being created.

Proxy contests are occasionally centered on dissidents' ideas about potential bankruptcy filings; one contest in the study period was filed in protest of management's plan of liquidation for the company (though, as the dissidents received 100% of seats on the board, that contest did not result in the creation of a hybrid board and is not included in this study.) Among all the hedge funds, private equity firms, potential strategic acquirers, founders, current directors, former executives or directors, or other non-institutional shareholders in the study group who initiated contests leading to the creation of a hybrid board, however, none campaigned in favor of either a bankruptcy filing or a delisting. Bankruptcy was, nonetheless, one strategic outcome for six companies which had hybrid boards, or 5% of the study total. Excluding companies which have been sold, seven companies (6%) – only two of which had also filed for bankruptcy protection – have since been delisted.

Sale of the Company

Twenty-one companies with hybrid boards, or 18% of the study population, had announced or completed a sale of the company by January 2009, a slightly higher rate than the 13.2% of S&P 500 companies which were sold over the same period. This result, however, is also skewed (as Exhibit 10 indicates) by a very low showing – 7% – among companies whose proxy contest was completed in 2008. This may reflect in part the amount of time required for a successful sale process, as well as the looming macroeconomic challenges of the credit crisis and the recession. Among companies which completed their proxy contests in 2005 through 2007, 18 (24%) have since announced or completed a sale of the company.

Exhibit 10

Outcomes when a sale of the company was:

	Number of Contests					Percentage of Affected Contests				
	2005	2006	2007	2008	Total	2005	2006	2007	2008	Total
A dissident objective	4	11	8	18	41	100 %	100 %	100 %	100 %	100 %
Sale Announced/Completed	2	2	2		6	50 %	18 %	25 %	0 %	15 %
No Sale	2	9	6	18	35	50 %	82 %	75 %	100 %	85 %
Not cited by dissidents	14	20	18	27	79	100 %	100 %	100 %	100 %	100 %
Sale Announced/Completed	1	6	5	3	15	7 %	30 %	28 %	11 %	19 %
No Sale	13	14	13	24	64	93 %	70 %	72 %	89 %	81 %
All Hybrid Boards	18	31	26	45	120	100 %	100 %	100 %	100 %	100 %
Sale Announced/Completed	3	8	7	3	21	17 %	26 %	27 %	7 %	18 %
No Sale	15	23	19	42	99	83 %	74 %	73 %	93 %	83 %

Surprisingly, however, the 41 hybrid boards (35% of the study population) whose dissident directors had campaigned on a desire to see the company sold were marginally less likely to succeed in selling the company. Among 2005 boards, those which included dissidents campaigning for a sale managed to complete two sales, whereas other hybrid boards completed one sale. In each successive year, however – and overall for the entire study period – hybrid boards whose dissident members had campaigned for a sale announced or completed fewer sales than the rest of the hybrid boards.

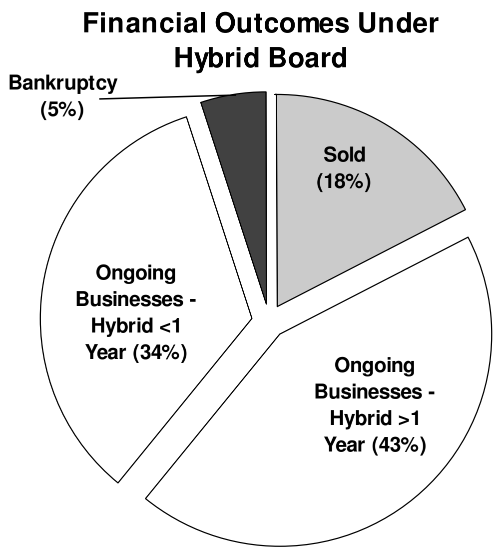
Even over the smaller timeframe of 2005 through 2007 (a period which excludes those hybrid boards which may simply not yet have had sufficient time since the proxy contest to effect a sale), however, the 23 hybrid boards whose dissident members had campaigned for a sale were successful in selling just 26% of those companies, versus a 23% sales rate for the other 51 hybrid boards created in that period. In absolute numbers, the latter group still announced or completed twice as many sales, 12 versus 6.

There remains an excellent possibility, of course, that certain dissidents, for tactical reasons, simply did not voice their intention to sell the company when they were campaigning for board seats. Even if such dissidents were responsible for all 12 additional sales, however – and assuming no other such dissidents failed to sell a company – only 18 of the 35 dissidents who intended (explicitly or implicitly) to pursue a sale – 51% – accomplished that objective even more than eighteen months after taking seats on the board.

Shareholder Value Under Hybrid Boards

> *"The moon and stars are now lined up for activists," says Barry Rosenstein, chief of [hedge fund] Jana Partners…. "One reason is that boards are getting a lot more sophisticated. They're far less willing to stand in the way when [an activist investor] tries to create shareholder value."*[33]

Survey of Financial Outcomes



Not all of the 120 companies whose hybrid boards were created as a result of real or threatened proxy fights between 2005 and 2008 were targeted because activists felt the companies were underachieving their business or strategic potential. Even in cases where the target company was a strong performer with a clear record of growth outstripping its peers, however, and the activist objectives were centered primarily on governance reforms, the dissidents characteristically framed their arguments to other shareholders in terms of suppressed or destroyed "shareholder value." To a large extent, then, the real measure of the success of a hybrid board – regardless of the particulars of the case activists made to gain seats on the board – should be the evaluation of increased or decreased shareholder value, particularly in relation to share price performance of the company's peers.

The vast majority of companies in the study were still stand-alone publicly-traded companies by January 2009. Hybrid boards had been seated for a year or more at 52 of these companies, or 43% of the study population, enabling evaluation of share price performance for at least a one-year and, for 15 of the companies, over a three-year period since the creation of the hybrid board. An additional 41 companies, or 34% of the study population, had less than 1 year of financial performance under the hybrid board – in some cases, less than one quarter – and were excluded from the analysis of financial results.

Business operations at the remaining companies in the study population were "wound up" in one way or another by January 2009. Six of these companies, or 5% of the study population, filed for bankruptcy (these companies are discussed in more detail beginning on page 34, and summarized in Exhibit 21). The remaining 21 companies, representing 18% of the study population, had announced or completed a sale of the company. (Companies sold under bankruptcy protection were excluded from this subset of the study population.) Because the period between the formation of the hybrid board and the announcement of the sale agreement varied substantially – from as little as 36 days to as much as 34 months – financial outcomes for companies sold under a hybrid board were evaluated by the premium or discount implied by the offer price. Offer price premium or discount was calculated versus two data points – the "undisturbed" trading price (generally, the closing price on the last day prior to the company's announcement either that it was seeking or that it had agreed to a sale), and the average trading price over the one-year period prior to the announcement of the sale.

Exhibit 11

	Present Status of Target Companies				
	Sold	**Bankrupt**	**Ongoing Business**	**Hybrid <1 Year**	**Total**
Institutional Investors					
Hedge Funds with Multiple Contests	9	1	18	18	46
One Hedge Fund, One Contest	5	3	19	11	38
Private Equity	1	-	-	1	2
Hedge Funds Acting as a Group	4	2	10	7	23
Institutional Investors	19	6	47	37	109
Non-Institutional Investors					
Founders	1	-	1	-	2
Current Execs/Directors	-	-	1	1	2
Former Execs/Directors	1	-	1	1	3
Other Non-Institutional	-	-	2	2	4
Non-Institutional Investors	2	-	5	4	11
Total/Average	21	6	52	41	120
Status by Selected Dissident Types					
Hedge Funds with Multiple Contests	20 %	2 %	39 %	39 %	100 %
One Hedge Fund, One Contest	13 %	8 %	50 %	29 %	100 %
Hedge Funds Acting as a Group	17 %	9 %	43 %	30 %	100 %
All Institutional Investors, incl. above	17 %	6 %	43 %	34 %	100 %
Non-Institutional Investors	18 %	0 %	45 %	36 %	100 %
Total	18 %	5 %	43 %	34 %	100 %

Other than for bankruptcy outcomes, as Exhibit 11 indicates, the incidence of these outcomes across categories of dissidents showed little variation. Individual hedge funds which ran multiple proxy contests resulting in hybrid boards had a slightly higher incidence (20% vs. study average 18%) of sale outcomes, while hedge funds which ran only one solo proxy contest resulting in a hybrid board had a slightly lower (13%) incidence of sales.

The low total number of bankruptcy outcomes – and in some cases the low number of hybrid boards within certain dissident categories – makes the bankruptcy incidence rates within dissident categories less useful. Non-institutional investors, for example, had a bankruptcy incidence rate of 0%; had just one of those 11 companies filed for bankruptcy, however, the incidence rate would have risen to 9.1%, nearly double the rate for the study population in total. It is notable that among hedge funds which ran multiple contests resulting in hybrid boards – 46 such contests in total, the largest number of any category – only one target company had filed for bankruptcy by January 2009.

As Exhibit 12 illustrates, among the subset of 52 ongoing businesses whose hybrid boards had been seated at least one year, absolute share price performance was positive over each of the time periods measured. More importantly, however, share price improvement – both in absolute terms and in relation to share price performance of peers – was strongest in the earliest measurement periods, then weakened as the period stretched further from the date when the dissidents gained their seats on the board.

Exhibit 12

	Ongoing Businesses			Sold		Bankrupt	<1 Year
				Premium/(Discount) to:			
	Contest Period	Init. 12 Months	Init. 36 Months	Undisturbed	1 Year Avg Price		
Target Companies in Sample	52	52	15	21	14	6	41
Average Months							
Absolute Performance							
Share Price Incr/(Decr)	9.8 %	5.0 %	0.7 %	29.9 %	15.9 %		
Standard Deviation (pct. pts)	28.9	53.4	109.8	37.3	28.7		
Relative Performance (pct. pts.)							
Avg. B/(W) Peers	9.1	3.6	(6.6)				
Standard Deviation	26.9	50.9	89.8				

- For the contest period itself (standardized to the three month period ending with the seating of the hybrid board), shares increased an average of 9.8%. This performance was also 9.1 percentage points higher than peers over the same period.

- For the twelve months following the contest, share prices of companies with hybrid boards averaged an increase of 5.0%, which was 3.6 percentage points higher than peers.

- Among the subset of 15 companies whose hybrid boards had been seated 3 years or more, share prices increased just 0.7% over the three year period following the contest, which was 6.6 percentage points worse than peers.

Perhaps most significantly, though, the individual outcomes within the group of ongoing businesses varied substantially, dwarfing the mean average results within each measurement period and significantly reducing the relevancy of those averages.

- For the 3-month contest period, the mean average absolute share price increase of 9.8% had a standard deviation of 28.9 percentage points. For the same period, the average increase of 9.1 percentage points versus peers had a standard deviation of 26.9 percentage points.

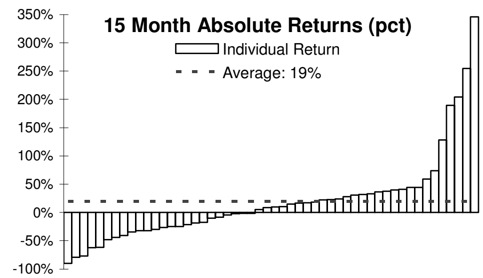
- For the 12-month period following the contest, the average absolute share price increase of 5.0% – barely half the average from the contest period – had a standard deviation approaching double that of the contest period, at 53.4 percentage points. Similarly, the average share price increase of 3.6 percentage points better than peers in the period came with a standard deviation of 50.9 percentage points.

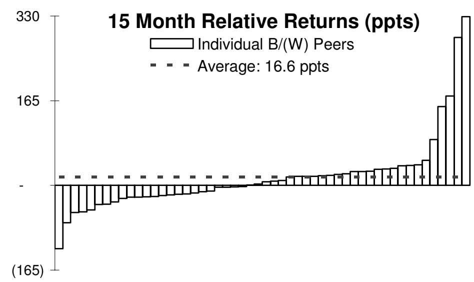
- o Over the 36-month period following the contest, the miniscule average absolute share price performance of 0.7% had a standard deviation of a whopping 109.8 percentage points, while the 6.6 percentage point decline versus peers over the same period had a standard deviation of 89.8 points.

While the three measurement periods make visceral sense for a study of the effectiveness of hybrid boards, any analysis of share price performance within discrete but successive time periods ignores the powerful compounding effect by which cumulative share price performance could far surpass the results of any one period. Much of the gain in shareholder value associated with the hybrid boards in this study occurred in the 3 month contest period itself, and was either compounded (or eroded) by the performance over subsequent periods. Including the compounding effect of the 12 and 36 month measurement periods on the 3 month contest period, then, share prices increased by an average of:

- o 19.1% over the 15 month period including the contest and the subsequent 12 months, and 21.5% over the 39 month period including the contest period and the subsequent 36 months.

- o 16.6 percentage points more than peers over the 15 month period and – by compounding a much larger contest period price appreciation, even at a slightly smaller rate than peers – by 17.8 percentage points more than peers over the 39 month period.





Among the 21 companies which announced or completed a sale by January 2009, the sale price premia averaged 27.1% versus the undisturbed share price, and 15.5% versus the average price over the year preceding the announcement of the sale. Here too, however, sale price premia varied substantially, for a standard deviation of 37.3 percentage points on premia versus undisturbed share prices, and 26.8 percentage points on premia versus the prior year's average closing price.

Among the six companies with hybrid boards which had filed for bankruptcy, four continued to trade – with very low volume – over the counter through January 2009. While share prices here, too, varied substantially – from a high of $0.06 (six cents) per share to a low of $0.0005 (five-ten-thousandths of a cent), in all cases greater than 99.9% of shareholder value had been lost.

Shareholder Value at Ongoing Businesses

The single most significant component of share price performance among the 52 ongoing businesses, considered overall, was the "contest effect" on share prices which occurred in the three months prior to the seating of a hybrid board, and which reflects the market's expectation of (or speculation about) changes the dissident campaign will bring.

The phenomenon is not unique to contests resulting in hybrid boards – or, for that matter, to proxy contests themselves. Numerous broader studies of hedge fund activism have found that companies targeted by hedge fund activists earn significantly higher share price returns over a period immediately following the initial 13D filing date than do companies not targeted for such activism. However, as one such study noted, these companies characteristically

> … do not show improvements in accounting performances in the year after the initial purchase. Instead, hedge funds extract cash from the firm through increases in the target's debt capacity and higher dividends. Examination of proxy fights and threats accompanying the activist campaign suggests that hedge fund managers achieve their goals by posing a credible threat of engaging the target in a costly proxy solicitation contest.[34]

Among those ongoing businesses where a threatened or actual proxy contest resulted in the creation of a hybrid board, however, that initial contest effect share price increase could provide a meaningful head start versus peers, giving the company a larger base against which to apply its subsequent 12 or 36 month price appreciation. Appendix 3 illustrates an extreme example of this contest effect.

Exhibit 13

1 Year Share Price Performance

		Absolute Performance Share Price Increase/(Decrease)			Relative Performance Price Performance B/(W) Peers			Additional Ongoing
	Ongoing Businesses	Contest Period*	Next 12 Months	Compound Total	Contest Period*	Next 12 Months	Compound Total	Businesses (<1 Year)
Institutional Investors	(count)	(pct)	(pct)	(pct)	(pct pts)	(pct pts)	(pct pts)	(count)
Hedge Funds with Multiple Contests	18	9.8 %	9.8 %	23.1 %	10.5	(0.2)	13.8	18
One Hedge Fund, One Contest	19	1.0 %	(5.8)%	(3.7)%	2.0	(1.0)	1.3	11
Private Equity								1
Hedge Funds Acting as a Group	10	15.0 %	15.2 %	33.0 %	9.5	14.1	27.3	7
Institutional Investors	47	7.3 %	4.7 %	14.4 %	6.8	2.5	11.6	37
Non-Institutional Investors								
Founders	1	(17.9)%	9.3 %	(10.3)%	(13.1)	(8.2)	(37.6)	-
Current Execs/Directors	1	13.5 %	7.7 %	22.2 %	(5.2)	27.2	27.4	1
Former Execs/Directors	1	2.5 %	2.8 %	5.4 %	16.4	17.0	31.0	1
Other Non-Institutional	2	83.9 %	11.6 %	150.8 %	77.0	16.8	148.1	2
Non-Institutional Investors	5	33.2 %	8.6 %	63.8 %	75.1	52.8	168.9	4
Total/Average	52	9.8 %	5.0 %	19.1 %	9.1	3.6	16.6	41
Standard Deviation		28.9	53.4	80.0	26.9	50.9	75.5	
Impact of 5 outliers >100% increase		11.1	17.9	39.6	11.2	18.9	44.3	

*Standardized to 3 month period ending with seating of hybrid board.

As Exhibit 13 indicates, the 52 ongoing businesses with at least one year of share price history following the creation of a hybrid board saw an average contest effect share price increase of 9.8%, or 9.1 percentage points better than peers. This average contest effect tended to be much higher (15%) when the proxy contest was the result of multiple hedge funds acting as a group, but slightly lower than average (7.3%) among all institutional investors as a group. Two proxy contests by non-institutional shareholders who were not company insiders added a full 3.0 percentage points to the combined average of all 52 companies, posting an average contest effect share price increase of 83.9% (77.0 percentage points higher than peers).

Over the 15 month period from the contest period through the subsequent 12 months, however, the average company with a hybrid board saw its share price increase by 19.1%, or 16.6 percentage points better than peers. Average relative returns were stronger for companies whose hybrid board was formed as a result of a proxy contest by hedge funds acting as a group, or by the non-institutional shareholders who were not previously company insiders.

Once again, however, the mean averages obscure striking disparities within the study population. Only 33 of the companies in the sample (67%) saw an increase in absolute share price over the contest period. Among these 33 companies, the contest effect averaged 22%, more than offsetting the average decline of 12% among the remaining 19 companies.

Negative absolute share price performance, however, could still have produced a contest effect which outperformed peers, just as positive share price performance may still have underperformed peers. Performance trends nonetheless translated closely from one evaluation method to the other. Share prices of 21 companies (40%) underperformed peers during the contest period by an average of 9.2 percentage points, while the remaining 31 companies outperformed peers during the contest period by an average of 21.5 percentage points.

For each group, moreover, approximately two-thirds of companies continued the trend of relative performance established in the contest period. Seven of the 21 companies (33%) which had underperformed peers in the contest period managed to overtake peers by the end of the 15 month cumulative period, recovering from an average 10.8 percentage point underperformance to post an average return 16.6 percentage points better than peers. Eleven of the 31 companies (35%) which had outperformed peers in the contest period ultimately reversed that trend, giving up an average 13.7 percentage point contest effect advantage to finish the 15 month cumulative period an average of 23.7 percentage points below peer performance.

For the 15 ongoing businesses with at least three years of share price history following the creation of a hybrid board, the average contest effect share price increase of 10.1% was marginally higher (0.3 percentage points) than the average for the larger group of 52 ongoing businesses with at least a year of share price history. Among the 3 year group, however, the contest period relative share price increase of 11.5 percentage points versus peers was 2.4 percentage points higher than the average of the larger group.

The sample size for the analysis of 3 year performance may be too small to provide meaningful findings about the longer term performance of companies with hybrid boards, particularly in terms of dissident subgroups within the sample. As Exhibit 14 indicates, however, nearly all the companies in the 3 year performance analysis were formed as a result of proxy contests led by hedge funds. Half (7 of 15) of those proxy contests were mounted by individual hedge funds responsible for multiple contests over the study period. For the contest period itself, these 7 companies as a group tended to have both higher absolute performance, at 12.7%, and higher relative performance, at 17.1 percentage points above peers, than the averages for all 15 companies in this subset. From the beginning of the proxy contest through the twelve months subsequent to the contest, however, these companies fell behind peer performance by 2.8 percentage points. Over the 39 month period covering the proxy contest and the subsequent 36 months after the formation of the hybrid board, performance among these 7 companies averaged 26.7 percentage points below peers.

Exhibit 14

3 Year Share Price Performance

Detail	Absolute Price Performance				Price Performance B/(W) Peers (ppts)			
			Contest Period Plus:				Contest Period Plus:	
Hedge Funds with Multiple Contests	Contest Period	Next 36 Mos	36 Months	12 Months	Contest Period	Next 36 Mos	36 Months	12 Months
A. Schulman Inc.	4.7 %	(19.0)%	(14.7)%	33.2 %	24.4	(41.1)	(13.9)	(23.3)
Steven Madden Ltd.	(4.9)%	72.0 %	63.7 %	189.5 %	5.6	(12.7)	17.2	153.5
Blockbuster Inc.	2.8 %	(73.0)%	(72.7)%	(48.1)%	3.1	(68.0)	(69.7)	(73.0)
SPX Corp.	9.3 %	155.0 %	178.3 %	36.0 %	8.8	126.3	148.9	17.6
Alliance Semiconductor Corp.	41.0 %	(84.0)%	(78.1)%	73.8 %	38.6	(33.6)	(32.1)	40.1
BKF Capital Group, Inc.	(16.8)%	(97.0)%	(97.9)%	(89.9)%	(15.9)	(193.1)	(180.4)	(123.3)
Ligand Pharmaceuticals Inc.	52.8 %	(75.0)%	(61.9)%	44.3 %	55.1	(73.3)	(56.7)	(11.2)
One Hedge Fund, One Contest								
Exar Corp.	(23.0)%	(54.0)%	(64.9)%	(21.4)%	(7.1)	4.1	0.8	(14.9)
OfficeMax Inc.	7.1 %	(39.0)%	(34.6)%	44.1 %	10.1	(41.4)	(33.3)	19.1
Spartan Stores Inc.	3.5 %	105.0 %	112.1 %	40.6 %	(4.4)	49.2	39.7	19.6
Wegener Corp.	(21.8)%	(78.0)%	(82.9)%	(40.6)%	(10.1)	-	(1.1)	(36.6)
Hedge Funds Acting As a Group								
BioMarin Pharmaceutical Inc.	65.3 %	289.0 %	543.3 %	204.3 %	58.5	298.3	562.4	174.2
GenCorp Inc.	8.3 %	(39.0)%	(33.7)%	17.0 %	3.0	(106.2)	(106.9)	(22.1)
Six Flags Inc.	10.0 %	(71.0)%	(67.9)%	27.9 %	8.1	(51.5)	(51.6)	39.1
Current Execs/Directors								
Quality Systems, Inc.	13.5 %	18.0 %	34.3 %	22.2 %	(5.2)	43.8	43.8	27.4
Summary								
Institutional Investors								
Hedge Funds with Multiple Contests	12.7 %	(17.3)%	(11.9)%	34.1 %	17.1	(42.2)	(26.7)	(2.8)
One Hedge Fund, One Contest	(8.5)%	(16.5)%	(17.6)%	5.7 %	(2.9)	3.0	1.5	(3.2)
Private Equity								
Hedge Funds Acting as a Group	27.9 %	59.7 %	147.2 %	83.0 %	23.2	46.9	134.6	63.7
Institutional Investors	9.9 %	(0.6)%	20.6 %	36.5 %	12.7	(10.2)	16.0	11.3
Non-Institutional Investors								
Founders								
Current Execs/Directors	13.5 %	18.0 %	34.3 %	22.2 %	(5.2)	43.8	43.8	27.4
Former Execs/Directors								
Other Non-Institutional								
Non-Institutional Investors	13.5 %	18.0 %	34.3 %	22.2 %	(5.2)	43.8	43.8	27.4
Weighted Average - All 15 Companies	10.1 %	0.7 %	21.5 %	35.5 %	11.5	(6.6)	17.8	12.4

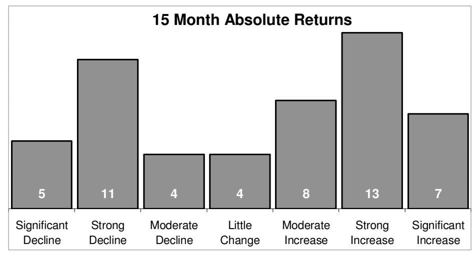
Single hedge funds mounting just one proxy contest in the study period were responsible for the creation of hybrid boards at 4 companies in the 3 year performance analysis. While on average those companies performed 2.9 percentage points worse than peers during the contest period, they completed the 39 month period slightly better than peers, at 1.5 percentage points above peers.

Hedge funds acting as a group were responsible for proxy contests which created hybrid boards at 3 of the companies in the 3 year performance analysis. Largely on the heady performance of one company – BioMarin Pharmaceuticals, whose share price increased by 58.5 percentage points over peers in the contest period, and 562 percentage points versus peers over the cumulative 39 month period – these companies averaged a contest period increase of nearly twice the average, at 23.2 points higher than peers, and 39 month performance which was 134.6 points better than peers. The other two companies, however – Six Flags and Gencorp – performed only modestly better than peers (5.6 percentage points) during the contest period, and averaged a 79.2 point decline versus peers over the 39 month period. On balance, as Exhibit 15 suggests, cumulative share price performance among ongoing businesses was distinctly (and unevenly) bimodal for both the 15 month and 39 month periods which began with the contest period.

Exhibit 15

Absolute Returns

	Change in Share Price		Contest Period Plus: 1 Year		Contest Period Plus: 3 Years	
	(pct)	(pct)	(count)	(mix)	(count)	(mix)
Significant Increase	better than	50 %	7	13%	4	27%
Strong Increase	50 % to	20 %	13	25%	1	7%
Moderate Increase	20 % to	5 %	8	15%	-	0%
Little Change	5 % to	(5)%	4	8%	-	0%
Moderate Decline	(5)% to	(20)%	4	8%	1	7%
Strong Decline	(20)% to	(50)%	11	21%	2	13%
Significant Decline	worse than	(50)%	5	10%	7	47%
Total			52	100%	15	100%

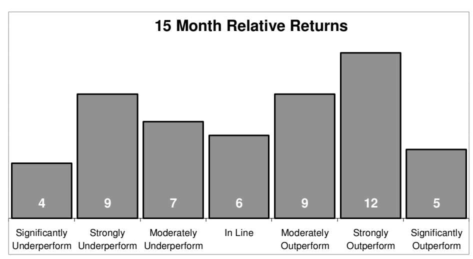


For the 15 month period, 20 companies (38%) delivered net price increases of greater than 20%, while 16 (31%) saw net price declines greater than 20%. Only 4 companies (8%) had returns of plus or minus 5% for the period. For the 39 month period, the disparity grew even starker. Five companies (34%) delivered net price increases of greater than 20% (for 4 of those 5, the increase was greater than 50%), while 9 companies (60%) saw share prices decline by more than 20% (for 7 of those 9, the decline was greater than 50%). No companies saw returns within plus or minus 5%.

Exhibit 16

Returns Relative to Peers

	Share Price Perf. B/(W) Peers		Contest Period Plus: 1 Year		Contest Period Plus: 3 Years	
	(pct. pts.)	(pct. pts.)	(count)	(mix)	(count)	(mix)
Significantly Outperform	better than	50	5	10%	2	13%
Strongly Outperform	50 to	20	12	23%	2	13%
Moderately Outperform	20 to	5	9	17%	1	7%
In Line	5 to	(5)	6	12%	2	13%
Moderately Underperform	(5) to	(20)	7	13%	1	7%
Strongly Underperform	(20) to	(50)	9	17%	2	13%
Significantly Underperform	worse than	(50)	4	8%	5	33%
Total			52	100%	15	100%



Relative to peer performance, as Exhibit 16 shows, the bimodality was much less stark, though still distinct, and for the one year performance measurement results were more encouraging for companies with hybrid boards. Twenty-six companies (50%) outperformed peers by at least 5 percentage points, while 20 companies (38%) underperformed peers by at least the same margin. Six companies (12%) were within plus or minus 5 percentage points, effectively performing in line with peers. For the 39 month performance measurement, however, 8 companies (53%) underperformed peers by at least 5 percentage points (and 5 of the eight by at least 50 percentage points), while only 5 companies (33%) outperformed peers by at least 5 percentage points. Two companies (13%) performed in line with peers.

Impact of Hybrid Board Characteristics

Modeling – let alone measuring – the factors which contribute to the relative success of a hybrid board for an ongoing business is beyond both the scale of the present sample size and the scope of this study. These factors would necessarily include appropriate targeting of companies by dissidents and the specific skill sets brought to the boards by the new dissident and independent directors, as well as the characteristics of the incumbent board and management team and the robustness of the economic engine of the company itself. It is worth recalling, as well, that a number of companies in the study were not actually targeted for poor prior performance, and their performance under a hybrid board may actually come despite the addition of new dissident or independent directors.

A simplified attribution analysis of certain observable characteristics of the dissidents behind the proxy contest, however, suggests that while certain popular assumptions about value creation, such as those about the size of the dissident ownership stake, may be true, others – such as those about levels of activist expertise and the number of new directors required to realize change – may be less accurate than commonly believed.

Exhibit 17

15 Month Relative Performance by Dissident Type

	Underperforming Peers			In Line	Outperforming Peers			Summary		
Dissident Type	Significantly	Strongly	Moderately	with Peers	Moderately	Strongly	Significantly	Total	Mix	Rating of Mean Perf.
	(< -50 pts)	(-20 to -50 pts)	(-5 to -20 pts)	(+/- 5 pts)	(+5 to +20 pts)	(+20 to +50 pts)	(> +50 pts)			
One Fund, Multiple Contests	3	2	3	2	2	4	2	18	35%	Moderately Outperform
One Hedge Fund, One Contest	1	4	2	3	6	2	1	19	37%	In Line
Hedge Funds Acting As a Group		1	2	1	1	4	1	10	19%	Strongly Outperform
Founders		1						1	2%	Strongly Underperform
Current Execs/Directors						1		1	2%	Strongly Outperform
Former Execs/Directors						1		1	2%	Strongly Outperform
Other non-institutional		1					1	2	4%	Significantly Outperform
Total	4	9	7	6	9	12	5	52	100%	Moderately Outperform

As Exhibit 17 indicates, the type of dissident appears to have relatively little relationship to how well a company's share price will perform over the cumulative 15 month period beginning with the contest period. While individual hedge funds running multiple contests may have more experience with the proxy contest phase itself, on average the companies at which they were successful in forming a hybrid board only moderately outperformed peers over the measurement period.

Companies whose hybrid boards were formed as a result of proxy contests in which several hedge funds acted as a dissident group did better, strongly outperforming peers. In both cases, however, results were both slightly bimodal and widely distributed across nearly all categories of performance from significantly underperforming to significantly outperforming peers.

Exhibit 18

15 Month Relative Performance by Dissident Ownership Stake

	Underperforming Peers			In Line	Outperforming Peers			Summary		
Dissident Stake	Significantly	Strongly	Moderately	with Peers	Moderately	Strongly	Significantly	Total	Mix	Rating of Mean Perf.
	(< -50 pts)	(-20 to -50 pts)	(-5 to -20 pts)	(+/- 5 pts)	(+5 to +20 pts)	(+20 to +50 pts)	(> +50 pts)			
<5%	2	2	2	1	1	1	1	10	19%	In Line
5.0% to 10%	1	4	2	4	5	6	2	24	46%	Moderately Outperform
10.1% to 25%	1	3	2	1	3	4	2	16	31%	Significantly Outperform
25.1% to 50%	-	-	1	-	-	1	-	2	4%	Moderately Outperform
Total	4	9	7	6	9	12	5	52	100%	Moderately Outperform

Exhibit 18 suggests that companies whose dissidents held more than a 5% ownership stake at the point of the proxy contest were more likely to outperform peers over the cumulative 15 month period. On average, performance under the 19% of hybrid boards where dissidents held less than 5% of shares was only in line with peer performance. When dissidents held 5% to 10% of shares, share price performance moderately outperformed peers. For the 31% of companies in which the dissidents owned between 10% and 25%, however, share price performance significantly outperformed peers, averaging 67.7 percentage points higher over the period.

As dissidents owned more than 25% of outstanding shares at only 2 companies in the sample (4%), the average results for those 2 companies – where share price increases moderately outperformed peers – may not be representative of the category.

Exhibit 19

15 Month Relative Performance by Number of New Directors Seated

Total New Directors Added to Hybrid Board	Underperforming Peers: Significantly (< -50 pts)	Underperforming Peers: Strongly (-20 to -50 pts)	Underperforming Peers: Moderately (-5 to -20 pts)	In Line with Peers (+/- 5 pts)	Outperforming Peers: Moderately (+5 to +20 pts)	Outperforming Peers: Strongly (+20 to +50 pts)	Outperforming Peers: Significantly (> +50 pts)	Summary: Total	Summary: Mix	Summary: Rating of Mean Perf.
New Independent Directors Only		1		2	2	1	1	7	13%	Strongly Outperform
1 Dissident Director		3	1		6	4	1	15	29%	Moderately Outperform
2 Diss. a/o Ind. Directors		2	3	3		1	3	12	23%	Significantly Outperform
3 Diss. a/o Ind. Directors	4	2	3			3		12	23%	Strongly Underperform
4 Diss. a/o Ind. Directors		1		1	1	1		4	8%	Moderately Outperform
5 Diss. a/o Ind. Directors						1		1	2%	Strongly Outperform
6 Diss. a/o Ind. Directors						1		1	2%	Strongly Outperform
Total	4	9	7	6	9	12	5	52	100%	Moderately Outperform

While it is a common contention that adding a single dissident director to a board is unlikely to be effective in bringing change, Exhibit 19 suggests adding a sole dissident director – or no dissidents, but appointing additional independent directors – is sometimes more effective than adding more than one dissident to a board. The 29% of boards which added a sole dissident director moderately outperformed peers, while the 13% of boards which added no dissidents, but appointed additional independent directors, strongly outperformed peers by an average of 30.9 percentage points.

In both cases, the average performance of these companies far exceeded the average of companies which added 3 new dissident (or dissident plus independent) directors. Companies which added a total of 3 new directors strongly underperformed peers by an average of 25.5 percentage points.

Exhibit 20

15 Month Relative Performance by % of Directors New to Board

% of Hybrid Board from Dissident & New Ind. Directors	Underperforming Peers: Significantly (< -50 pts)	Underperforming Peers: Strongly (-20 to -50 pts)	Underperforming Peers: Moderately (-5 to -20 pts)	In Line with Peers (+/- 5 pts)	Outperforming Peers: Moderately (+5 to +20 pts)	Outperforming Peers: Strongly (+20 to +50 pts)	Outperforming Peers: Significantly (> +50 pts)	Summary: Total	Summary: Mix	Summary: Rating of Mean Perf.
<10%	-	1	1	-	3	1	-	6	12%	Moderately Outperform
10.0% to 20%	-	3	-	4	4	4	2	17	33%	Moderately Outperform
20.1% to 30%	-	3	4	-	1	3	2	13	25%	Strongly Outperform
30.1% to 40%	2	-	2	1	1	-	1	7	13%	In Line
40.1% to 50%	1	1	-	1	-	2	-	5	10%	In Line
>50%	1	1	-	1	-	1	-	4	8%	In Line
Total	4	9	7	7	9	11	5	52	100%	Moderately Outperform

In terms of the percentage of a hybrid board which is composed of new dissident and independent directors, Exhibit 20 strongly suggests that a smaller percentage is better than an overwhelming percentage, though the ideal may be in the range to 20% to 30% of board seats. The 31% of companies for which new directors comprised more than 30% of the hybrid board performed only in line with peers.

The 45% of companies where new directors composed less than 20% of the hybrid board, by contrast, moderately outperformed peers, and the 25% of companies where new directors made up 20% to 30% of the hybrid board strongly outperformed peers by an average of 23.8 percentage points.

Shareholder Value at Companies "Wound Up" by Hybrid Boards

Twenty-seven of the 120 companies with hybrid boards, or 23% of the sample, are either no longer publicly traded or have announced plans to sell or liquidate the company.

Bankruptcies

Of the six companies with hybrid boards which had filed for bankruptcy protection by January 2009, four are still (nominally) publicly traded – though three of the four either are in the process of, or have completed, liquidation – and two have been sold. On average, the companies filed for bankruptcy more than 16 months after the creation of the hybrid board. While that period of time has varied from as much as 31.7 months to as little as 4.6 months, it has decreased steadily from the one company which settled its proxy contest in 2005 to the one which settled in 2008.

Exhibit 21

Target Companies Which Have Since Filed for Bankruptcy

	RedEnvelope Inc.	New Century Financial Corp.	Sharper Image Corp.	Bally Total Fitness Holding Corp.	WCI Communities Inc.	Circuit City Stores, Inc.
Year	2005	2006	2006	2006	2007	2008
Sector	Online Retail	Residential Mortgage	Specialty Retail	Health & Fitness	Home Builder	Specialty Retail
Dissidents						
One Hedge Fund, Multiple Contests					✔	
One Hedge Fund, One Contest		✔	✔			✔
Hedge Funds Acting as a Group	✔			✔		
Ownership Stake	18%	6%	13%	25%	15%	7%
Seats Sought	4	3	7	3	10	5
Seats Open	9	3	7	3	10	5
Contest Outcomes						
Settlement	✔	✔	✔		✔	✔
Shareholder Vote				✔		
Hybrid Board Formed	8/26/05	3/31/06	7/6/06	1/26/06	8/30/07	6/24/08
Dissidents Seated	0	1	3	3	3	3
Add' Ind Directors	3	0	3	0	3	
% of Hybrid Board	33%	9%	33%	33%	30%	20%
Board Expanded?	No	No	Yes	No	No	Yes
Bankruptcy						
Date of Filing	4/18/08	na	2/20/08	6/27/07	8/4/08	11/10/08
Months from Contest to Filing	31.7	na	19.5	17.0	11.1	4.6
Closing Price on 2/3/2008	$ 0.0005	na	$ 0.0400	na	$ 0.0600	$ 0.0060
Present Status	Liquidated	Sold	Liquidated	Controlled by Hedge Fund	Unresolved (Liquidation Likely)	Liquidating

Interestingly, as Exhibit 21 shows, the ownership stake of the dissidents – all of them hedge funds – was relatively high at the time of the proxy contest, ranging from 6% to as much as 25%. The dissidents tended to seek control by running full slates of nominees, and generally received a relatively large percentage of seats on the hybrid board (in four cases, 30% to 33% of seats).

While half the boards agreed to add additional independent directors (in each case, 3 new directors), so that on average each company added 3.7 new dissident or independent directors, in only one of the six cases did the dissidents fail to place any of their nominees on the board. In five of the six cases, the proxy contest was resolved through a settlement agreement rather than a shareholder vote.

Three of the bankruptcies were either online or specialty retailers, and two were in housing-related industries (mortgages or homebuilding). While the sample may be too small to generalize about any particular industry segment, what these companies do seem to have in common is a vulnerability to economic downturn (particularly a housing-led downturn, such as the subprime-related housing crisis which began in 2007). Not surprisingly, then, the bankruptcy filings occurred overwhelmingly in mid 2007 and throughout 2008 – regardless of the year the hybrid board was formed – as the subprime crisis devolved into a much broader economic recession.

While the bankruptcy rate of 5% in the study sample seems high, it is not at all clear that bankruptcy risk is in fact heightened under a hybrid board.

Almost by definition, proxy contests are waged at companies where dissidents perceive a real risk of value destruction, so that a thorough analysis of bankruptcy risk under the resulting hybrid boards would require looking, as well, for evidence of companies which averted bankruptcy because of the successful proxy contest. Given that none of the companies in the study filed for bankruptcy until mid-2007 – more than halfway through the study period, and only after a significant macroeconomic downturn – it is entirely plausible that the intervention of hybrid boards enabled a number of otherwise high-risk companies to avert bankruptcy, and that on average (and after adjusting for larger macroeconomic variability) hybrid boards may actually reduce bankruptcy risk. Full exploration of these issues, however, is beyond the scope of this study.

Sales

As Exhibit 22 indicates, a significant minority – 21 companies, or 18% of the total survey population – have either announced or completed a sale, at an average premium to the pre-announcement ("undisturbed") share price of 27.1%. The relative size of the price premium varies substantially within this small sample, however, from a premium of 159.3% to a discount of 2.8%. On average, a sale was announced 10.1 months after the hybrid board – with an average of 2.0 dissident directors and 0.3 additional independent directors – was seated.

Though the data from companies whose hybrid boards were formed in 2008 is likely still immature, given the relatively short period since many of those proxy contests were resolved, the three sales generated from those companies represent both the highest average premium, at 78.8%, and the highest individual premium in the group, at 159.3. Despite the constraints of the developing U.S. credit crisis, moreover, these sales averaged a premium to the one year average closing price of 19.4%, 3.5 percentage points higher than the mean for all sales of 15.9%.

Exhibit 22

Companies Sold Under Hybrid Boards*

	2005	2006	2007	2008	Total	Settled	Voted
Contest Resolution							
Settlement	3	7	5	3	18		
Shareholder Vote	-	1	2	-	3		
Total	3	8	7	3	21	18	3
Average:							
Months to Sell	12.6	16.7	4.4	3.7	10.1	10.5	7.9
Diss. Ownership	5.2 %	11.8 %	6.7 %	11.7 %	9.2 %	10.0 %	4.3 %
Dissident Dirs Added	1.7	2.0	2.3	1.3	2.0	1.9	2.0
Add'l Ind. Dirs Added	-	0.3	-	1.0	0.3	0.4	-
New Dirs. (% of Board)	17.4 %	19.6 %	28.4 %	19.3 %	22.2 %	22.0 %	23.2 %
Price Premium/(Discount) to:							
"Undisturbed Price"	1.4 %	25.9 %	15.5 %	78.8 %	27.1 %	29.6 %	13.5 %
Min	(2.8)%	0.4 %	5.2 %	37.0 %	(2.8)%	(2.8)%	0.4 %
Max	9.0 %	74.1 %	34.8 %	159.3 %	159.3 %	159.3 %	34.8 %
Average Prior Year Price	7.6 %	3.2 %	26.4 %	19.4 %	15.5 %	12.2 %	38.5 %
Min	4.4 %	(59.0)%	14.0 %	(8.3)%	(59.0)%	(59.0)%	33.6 %
Max	10.7 %	50.0 %	43.3 %	33.4 %	50.0 %	50.0 %	43.3 %

*Excludes companies sold or liquidated while under bankruptcy provisions.

Not surprisingly – given that hybrid boards were three times as likely to be formed through a settlement agreement as through a shareholder vote – the overwhelming majority of sales (18, or 86%) were at companies where the hybrid board was created through a settlement agreement. There was, however, a significant difference in premia to the undisturbed share price: companies whose hybrid boards were created through contest settlements averaged a sale premium of 29.6%, more than double the 13.5% average premium for companies whose hybrid boards were created by a proxy contest which went to a shareholder vote.

Findings and Conclusion

This study examined the effectiveness of 120 hybrid boards created between 2005 and 2008 when a real or threatened proxy contest resulted in a combination of incumbent, dissident, and/or new, mutually agreed independent directors. Board effectiveness was evaluated both in terms of demonstrable changes in governance and strategy, as compared to the dissidents' explicit campaign agendas, and increases in shareholder value, as measured in both absolute returns and returns relative to peers.

While individual companies sometimes demonstrated substantial change on certain measurements, in general the explicit objectives behind the dissident campaigns were not necessarily reliable indicators of change under the subsequent hybrid board. Not surprisingly – in a finding which echoes the results of numerous academic studies of hedge fund activism more broadly – improvements in shareholder value were substantially the result of a sizeable contest effect increase in share prices, as the market priced in its expectation of change a hybrid board might bring, followed by much less striking performance over subsequent periods.

Among the specific research findings of this study are:

- The significance of governance concerns in the dissident campaigns which led to hybrid boards declined from being the most frequently cited rationale in 2005 – when 33% of dissidents cited such concerns, a higher rate than performance concerns, strategic issues, or forcing a sale of the company – to being the least cited rationale in 2008, when performance concerns were cited three times as often.

- On average shareholder value at ongoing companies improved under hybrid boards by 19.1% – 16.6 percentage points more than peers – from the contest period through the board's one year anniversary. More than half of that gain came during the three month contest period: average share prices increased only by a more modest 5.0% over the ensuing year (though still 3.6 percentage points better than peers).

- For shareholders, the risk of failure was substantially greater than this average return might indicate:

  Absolute Return: share prices of one-third of ongoing companies in the study lost an average of 11.7% during the contest period, offsetting more than half the average 22.2% gain among the remaining two-thirds of companies. From the contest period through the subsequent twelve months, for which the average share price increase averaged 5.0%, nearly half (45%) of the ongoing businesses saw their share price decline by an average of 1.0%, offsetting much of the 18.4% gain among the remaining firms.

Relative Return: share prices at two of five ongoing companies in the study underperformed peers by an average of 9.2 percentage points during the contest period, offsetting nearly half the average 21.5 percentage point outperformance of the remaining companies in the study. From the contest period through the subsequent twelve months, 46% of companies underperformed peers by an average of 29.0 percentage points, offsetting more than half the average 55.7 percentage point outperformance of the remaining companies in the study.

- Among the 15 ongoing businesses with at least three years of performance data since the creation of their hybrid boards, share price performance averaged just 0.7% over the 36 month period – 6.6 percentage points worse than peers. Total share price performance for the 39 months from the contest period through the three year anniversary of the hybrid board, however, averaged 21.5% – 17.8 percentage points higher than peers – again largely on significant contest period price appreciation averaging 10.1%

- Strong positive share price performance over the 15 months from the contest period through the hybrid board's first anniversary was increasingly likely when the dissidents leading the proxy contest owned a significant percentage of shares. When dissidents held less than 5% of shares, performance was only in line with peers, and when dissidents held 5% to 10% of shares, share price performance moderately outperformed peers. When dissidents owned between 10% and 25% of shares, however, performance significantly outperformed peers by an average of 67.7 percentage points.

- Although 35% of hybrid boards were formed by dissidents who had an explicit objective to sell the company, only 15% of this group – had announced or completed a sale transaction by January 2009. This sales rate was actually lower than the 19% sale rate of among the rest of the study population. Even excluding 2008 hybrid boards (which may not have yet had sufficient time to negotiate a sale), only 26% of hybrid boards whose dissident members had explicitly sought a sale of the company had announced or completed a transaction. For all other hybrid boards in the study, the sales rate of 24% was only marginally different.

- Bankruptcy, though not an objective of any dissident groups in the study, was nonetheless the outcome under 5% of hybrid boards in the sample, resulting in loss of greater than 99.9% of shareholder value at those companies. It is not clear that bankruptcy risk is in fact heightened under hybrid boards, however, since a thorough analysis of that question – which would also evaluate whether certain companies in the study were able to avert bankruptcy through the intervention of a hybrid board – is beyond the scope of this study.

Appendix 1: Case Studies

Happy families are all alike; every unhappy family is unhappy in its own way.

-- Leo Tolstoy

Although every dissident proxy contest has its own specific causes, in aggregate it seems evident that contests often fit certain archetypal patterns. In some instances those patterns provide deeper context for the dissidents' own explanation of what drives the conflict; in others, they help explain the trajectories not just of the contest, but of the surviving company.

The following six case studies of proxy contests resulting in hybrid boards covered by the study amplify certain of these archetypes:

1. The Governance Reformer: H&R Block, Inc. – Dissidents with strong governance credentials are able to push through major governance and strategic changes at a company.

2. The Quick Wrap-Up: Datascope Corp. – Dissidents who want to see the company sold negotiate and complete a sale before their board seats are warm.

3. Going Down With the Ship: WCI Communities, Inc. -- Dissidents win board seats at a troubled company but are unable to reverse the company's fortunes on the ride down into bankruptcy.

4. Through the Looking Glass: Take-Two Interactive Software, Inc. – After campaigning to clean up managerial misbehavior and corporate performance, dissidents entrench themselves in board and management positions amid a worsening spiral of misbehavior and performance.

5. Tag-Team Dissidents: Topps Co. – Multiple dissidents mount successive proxy contests over several years, as one group after another proves unable to subdue a powerful trend of disappointing corporate performance.

6. The Return of the King: Vineyard National Bancorp – A disgruntled former executive or director, whose departure often was involuntary, mounts a campaign to return to the throne.

The Governance Reformer: H&R Block Inc.

In most proxy fights, the dissidents base their case for changes at the target company on several rationales – with sub-par company performance, misguided strategy and poor governance practices being among the most frequently cited reasons. The credibility and effectiveness of dissident assertions about these perceived inadequacies can vary widely, however. In contests where corporate governance is a central issue, the success of dissidents may depend on the governance track record of both the target company and the dissident group itself.

The proxy contests where governance arguments appear to gain the most traction with shareholders are those where the dissidents bring a strong background in corporate governance expertise. A prominent example of a contest where the dissidents had such expertise was the 2007 contest involving Breeden Partners and H&R Block – in which the dissidents made corporate governance reforms a central part of their agenda and, interestingly, the company staked part of its defense on governance issues as well. A central issue in this contest was also a debate over whether the company's strategy of attempting to build a financial supermarket was likely to be successful.

Proxy contest background and company situation:

H&R Block was a company struggling with significant challenges to its business model when Breeden Partners first bought a stake in the company in November 2006. The company's core business, tax preparation services, had a strong presence and brand recognition in both on-line and software products as well as through company-owned and franchised retail stores. In addition, the company had extended its services to corporations by offering accounting, tax and business consulting services under the RSM McGladrey brand to middle market firms. In an effort to extend its brand to other financial service areas, however, the company had also diversified well beyond its core business, entering the securities brokerage, subprime mortgage lending and consumer banking segments, often through acquisitions.

The results of these efforts were generally quite poor, resulting in more than $400 million in operating losses from the new businesses from 2000 through 2006. Meanwhile, the operating performance of the company's core tax business also declined significantly as the company focused on its diversification efforts. As a result, earnings per share had declined steadily from $1.92 in fiscal 2004 to a loss of $1.33 per share in fiscal 2007. Somewhat belatedly, the company had recognized the problems with its "financial supermarket" strategy and had developed a plan to exit many of its non-core businesses. The plan included the sale of its Option One subprime mortgage subsidiary, closing H&R Block Mortgage Corp. and selling the unprofitable units of its RSM McGladrey business. But management wanted to continue to invest in H&R Block Bank, launched in May 2006, arguing that the bank was the future foundation for increasing customer loyalty and market share in key segments of its core retail tax business.

Dissident profile and background:

Breeden Partners LP, a private investment firm, was formed to invest in underperforming companies. The company says it "seeks to invest in companies with strong cash flows and underlying asset values where it can be a catalyst for change that will enhance market value." Specifically, it seeks to persuade portfolio companies to "adopt new strategies to increase earnings and rates of return, improve capital allocation, strengthen accountability for performance, enhance transparency and adopt healthier governance practices."

The firm's founder, Richard Breeden, is chairman and CEO of Breeden Capital Management and is also chairman of Richard C. Breeden & Co., LLC, a professional services firm specializing in strategic consulting, financial restructuring and corporate governance advisory services. Breeden is also the former chairman of the Securities and Exchange Commission (SEC), the former U.S. Department of Justice-appointed corporate monitor for WorldCom, Inc., and the current corporate monitor for KPMG, LLP, relating to the accounting firm's role in the design and marketing of tax shelter products. Prior to launching its proxy contest at H&R Block, Breeden Partners had settled a threatened proxy contest at Applebee's in 2006, winning two board seats and pushing for a strategic review and a sale of the company, which eventually occurred in November 2007.

Dissident agenda and views:

Breeden Partners acquired its initial 1.8% stake in H&R Block in November 2006. Because its stake was below the 5% threshold required for filing a Schedule 13-D ownership statement, the first public filing related to the proxy contest was a Schedule 14-A definitive proxy solicitation filing made on June 27, 2007, announcing Breeden Partners' intent to nominate Breeden and two other nominees at the company's annual meeting in September--where the company had three nominees up for election. Soon thereafter, on July 6, Breeden filed a preliminary proxy statement naming the two other nominees on his slate and stating that, if elected, the Breeden nominees would seek to persuade the board to "return to the company's roots by concentrating on its tax businesses" and to "end further use of shareholder capital to pursue subprime mortgage lending, securities brokerage, banking and other non-core activities."

Breeden's other two nominees in the contest were Robert A. Gerard, the CEO of Royal Street Communications, a telecommunications network operator, and L. Edward Shaw, senior managing director of Breeden & Co. Gerard was formerly an assistant secretary of the U.S. Treasury for capital markets and a senior partner or officer at Morgan Stanley & Co., Bear Stearns and Dillon Read. Shaw is the former general counsel of Aetna Inc. and Chase Manhattan Bank and a former independent counsel to the board of the NYSE.

In a series of press releases and proxy solicitation filings leading up the annual meeting, Breeden focused on several key failings in the company's past diversification strategy, its declining stock price and on his specific plans to improve shareholder value. Regarding H&R Block's past performance, Breeden said that the company's strategy had caused its stock price to underperform the S&P 500 by 88% over the past five years—which he attributed primarily to failed diversification efforts and declining operating performance in its core tax services business.

Concerning the diversification moves, Breeden said the company had spent nearly $2 billion on acquisitions with low or negative returns on invested capital and that the board lacked sufficient expertise in securities brokerage, banking and capital markets to oversee the risks in these areas. He also noted that the return on assets in the company's "crown jewel" tax services business had declined by 50% since 2002 -- from about 156% in 2002 to 78% in 2007 – which he attributed to the company's focus on other activities such as subprime lending. Breeden was also particularly critical of the company's move to form H&R Block Bank, which he said limited the company's flexibility with regard to implementing an optimal capital structure because of bank capital requirements. Breeden maintained that any synergy advantages associated with debit cards or other financial products that could be sold to tax preparation customers could easily be obtained through partnerships with other financial institutions.

Finally, with regard to its own plan to create value, Breeden Partners said that its nominees, in addition to bringing a shareholder voice and relevant oversight experience to the board, would push for several strategic and governance changes, including:

- Sell H&R Block Bank, which would eliminate any restrictions on the company's ability to repurchase shares and allow the company to utilize an efficient capital structure;
- Stop the bleeding at the Option One subprime mortgage unit by curtailing any further growth in subprime exposure and selling the unit with the lowest possible net losses;
- Consider divesting the company's securities brokerage business, which was likely to generate poor returns on capital in the future;
- Focus on expanding margins and maximizing cash flow in tax-related businesses where the company enjoyed the most significant competitive advantages;
- Explore re-franchising opportunities for company-owned stores; and
- Implement a number of corporate governance reforms, including declassifying the board, separating the positions of CEO and chairman, eliminating the executive committee, creating a risk management committee, establishing stringent performance goals and standards for senior management and establishing a guideline to limit board service to 12 years.

Management views and responses:

The company urged shareholders to protect their investment by voting for its nominees. It argued that Breeden was confused about H&R Block's business and that his strategies were misguided because he failed to understand the full potential for new initiatives already underway, especially related to the bank. The company argued that Breeden's "cookie-cutter" strategies, such as re-franchising "may have worked at Applebee's but tax returns are not prepared in a kitchen."

The company noted that it had already embarked on a plan to improve performance and to re-focus on its core tax and financial services businesses and to grow shareholder value. Among the key initiatives in this plan were:

- An agreement to sell Option One Mortgage and to close the H&R Block Mortgage business because those operations were not aligned with the company's strategic focus or return expectations;
- Exiting certain operations within its core accounting business (RSM McGladrey) that were not profitable;
- Improving the operating and financial performance of the securities brokerage business;
- Using the bank to enhance the company's ability to attract and retain customers, especially early tax filers; and
- Examining the strategic importance of all of its businesses and their contribution to shareholder value.

Aside from strategy considerations, the company argued that it had strong corporate governance, including nine (out of 11) independent directors on its board and stock ownership requirements for directors. It noted an earlier decision, taken on Aug. 13, 2007, to amend the company's bylaws to declassify the board effective at the 2008 annual meeting.

Finally, the company devoted considerable attention to the argument that Richard Breeden's role as a government-appointed independent monitor for the accounting firm KPMG created a conflict of interest because KPMG served as the company's audit firm. The company argued that if Breeden's presence on the board meant that KPMG could no longer be considered independent, and it had to step down as H&R Block's auditor, the change would be costly and disruptive.

Factors in the contest and outcome:

The dissident group appears to have been aided in the contest by substantial support for their position by major shareholders, proxy advisory firms and equity analysts. Several weeks prior to the annual meeting, on Aug. 19, 2007, an article published by FT.com announced that two of the company's significant shareholders, Ariel Capital Management (5.1%) and Harris Associates (6.6%) intended to vote their shares in favor of the dissident slate. In addition, a number of equity analyst reports available near the time of the proxy contest showed that analysts appeared to agree with Breeden regarding the company's lack of focus on its core tax business and the negative consequences of the capital requirements associated with the bank. Finally, at least two of the major proxy advisors, ISS and Proxy Governance, recommended that their clients support the dissident nominees.

The outcome of the election was a decisive victory for the dissidents. The three dissident candidates each received support from more than 226 million shares, with Richard

Breeden getting nearly 233 million, while each of the three company nominees were supported by slightly less than 50 million shares.

Company changes and actions after the contest:

Following the dissident victory in the proxy contest, the company undertook significant changes to its management and governance. In November 2007, the company's Chairman, President and CEO, Mark Ernst, and its Executive Vice-President and CFO, William Trubeck, both resigned. Alan Bennett was appointed interim CEO and Becky Shulman was appointed acting CFO. Richard Breeden was subsequently named non-executive Chairman. Later, in March 2008, the company named a permanent CFO and, in July 2008, a new permanent CEO.

On the governance front, the company held a special meeting on Dec. 14, 2007, to allow shareholders to ratify the board's previous decision to amend its articles to declassify the board. In March 2008, the company allowed its poison pill to expire. In June 2008, it adopted a bylaw amendment providing for the presentation of a "say on pay" advisory vote on compensation at each annual meeting. Then, at the September 2008 annual meeting, the company sponsored management proposals to implement a number of other governance reforms, including:

- an amendment its articles to separate the chairman and CEO and chairman roles;
- an amendment to its articles to reduce the permissible number of directors from a range 9 to 15 to a range of 7 to 12;
- an amendment to its articles to set director term limits of 12 years; and
- an amendment to its articles to "declaw" its preferred stock by setting limits on voting rights.

On the business front, the company closed the sale of its Option One Mortgage loan servicing business for $1.3 billion on April 30, 2008. The company announced in July 2008 that it would initiate a $2 billion stock buyback program through 2012. In November 2008, it completed the sale of its financial advisor business, H&R Block Financial Advisors, to Ameriprise for $312 million. The company also spent $278 million to purchase the operator of its tax preparation franchise units in Texas, Arkansas and Oklahoma, adding 621 office locations serving 760,000 clients.

Situation at year-end 2008:

By all accounts, H&R Block has made some progress in strengthening its business and balance sheet since the Breeden group's involvement with the company. The company has returned to profitability, recently reaffirming earnings guidance for fiscal 2009 of $1.60 to $1.70 per share, and has refocused on its core businesses. Debt was reduced by nearly $1.2 billion during 2008. The issue over the future of H&R Block Bank remains unresolved and that unit has continued to generate losses, producing an $18.6 million loss in the 2009 fiscal 2nd quarter, due mainly to $38 million in loan loss provisions related to the bank's mortgage loan portfolio. As of Oct. 31, 2008, the bank held $610 million in mortgage loans that it bought from the company's former Option One and H&R Block Mortgage Corp. units, with delinquency rates on these loans continuing to increase.

The company's stock has significantly outperformed the market since Breeden Partners' involvement. H&R Block common stock closed on Dec. 31. 2008, at $22.72 per share, approximately even with the stock price when Breeden Partners bought its initial stake in November 2006, but up nearly 20% since Richard Breeden was named chairman in November 2007. During the same November 2006 to December 2008 period, the S&P 500 index fell by approximately 35 percent.

The Quick Sale: Datascope Corp.

Proxy contest background and company situation:

Datascope was a diversified medical device company, founded in 1964, that developed, manufactured and marketed products for the clinical healthcare market. It had four main business lines -- cardiac assist products, patient monitoring products, interventional products, and vascular products, of which the cardiac assist and patient monitoring lines contributed the lion's share of the company's revenues. Datascope's revenue growth in the five years leading up the proxy contest had been anemic and its earnings per share had been inconsistent, leading to a sustained period of stock price underperformance relative to both its peer healthcare companies and the broader market indices.

In the months preceding the proxy contest, the company and its 79 year-old Chairman, CEO and founder, Lawrence Saper, had also been hit with several allegations of ethical violations. Most of the allegations related to transaction irregularities between Saper and the company, as well as deficiencies in expense reporting by Saper and special treatment under benefits programs for his son. Internal investigations of the issues were conducted by both the company's internal audit department and, later, the Audit Committee of the board. The investigations, however, stoked further controversy when they concluded that while there was no evidence of wrongdoing on the part of Saper, changes were needed to company policies and procedures. Saper also volunteered to reimburse the company for certain expenses. In the three months following the reports of alleged ethics violations, between March and May 2007, at least five company executives, including the CFO, the Chief Information Officer and the Corporate Counsel, had resigned.

On Sept. 24, 2007, representatives of Ramius Capital Group participated in a conference call with Datascope's CFO to try to gain a better understanding of the company's strategy, business segments and markets. Ramius bought its first shares of Datascope stock the next day. On Oct. 15, Ramius representatives had another conference call, this time with Datascope CEO Saper, to discuss, among other things, board representation. Ramius sent a letter to the company on the same day, expressing its desire to meet with the company's Nomination and Governance Committee to discuss the inclusion of its nominees on the company's board slate. Absent such a decision, Ramius also announced its intention to solicit proxies for its nominees.

By Oct. 19, 2007, Ramius Capital had accumulated a 2.4% stake in the company through its Starboard Value and Opportunity Master Fund affiliate and it filed a preliminary proxy statement with the SEC stating its intention to nominate and solicit proxies for two nominees to the company's board. Ramius continued to buy stock, reaching an ownership stake of 3.2% by Nov. 1, 2007, and ran a proxy contest to replace the two Datascope directors up for election with two of its own nominees.

Dissident profile and background:

Ramius Capital Group, LLC is a registered investment advisor that manages assets in a variety of alternative investment styles, including multi-strategy and single strategy hedge funds and fund of funds. The firm, which was founded in 1994 and has approximately $10 billion in assets under management, is headquartered in New York, with offices in London, Tokyo, Hong Kong, Munich and Vienna. The company says its investment strategies are "designed to address both institutional and high net worth individuals' needs to preserve and grow allocated capital on an absolute basis."

Ramius' Managing Members are Peter Cohen, Jeffrey Solomon, Morgan Stark and Thomas Strauss. Cohen, the founder of Ramius, is the former Chairman and CEO of Shearson/American Express. Solomon was formerly Chief Administrative Officer at Republic New York Securities Corp. and worked in the mergers and acquisitions group at Shearson Lehman Brothers. Stark held various positions at Chase Manhattan Bank, Chemical Bank and Granite Capital International Group. Strauss is the former President of Salomon Brothers and former Vice-Chair and member of the board of directors of Salomon Inc.

Ramius Group is no stranger to proxy fights. In early 2007, it settled a proxy contest at Phoenix Technologies Inc. after the company agreed to put two of its nominees on the board. Meanwhile, at almost the same time that it was mounting the Datascope contest, Ramius won another proxy contest to get two of its nominees elected to the board at A. Schulman Inc. and lost a contest at Luby's Inc. to replace four nominees to that company's board.

The two Ramius nominees for the Datascope board were David Dantzker, M.D., and William Fox. Dantzker is a general partner at Wheatley Medtech Partners, a venture capital firm specializing in medical technology, and served on the boards of a several medical technology companies. Fox is a business advisor and strategy consultant who had also served in executive roles and on a number of boards, but who had limited experience in the medical technology field. Neither nominee had any direct business relationship with Ramius.

Dissident agenda and views:

The dissidents contended that Datascope had significant operational and governance issues that were eroding shareholder value. On the operational side, they noted that despite significant investments in R&D, equivalent to $16 per share in capital investments, the company had experienced sub-par growth since 2000. They said the company had also failed to contain costs by ignoring possibilities for offshore manufacturing. Ramius questioned the credibility of the company's strategic plan, and of management's ability to execute it, arguing that the company had lost market share in some of its key markets while management had focused on diversifying into other, highly competitive, markets. As a result, the company's total return to shareholders since 1992 had been 89%, versus a 350% return for the S&P 500.

The dissidents saved some of their harshest criticism, however, for the company's governance and ethics practices. They said that the company's refusal to provide shareholders with clear answers to the allegations about ethics violations involving CEO Saper, coupled with subsequent executive turnover, was "symptomatic of questionable management practices and poor corporate governance." They argued that "the effectiveness of the board has been undermined by a dominant founder, Chairman and CEO." They specifically criticized various anti-takeover measures adopted by the company, including a poison pill, a high 50.1% threshold vote required for shareholders to call a special meeting, the ability for the board to add directors without shareholder approval and the company's ability to issue "blank check" preferred stock. The dissidents said that, if elected, they would support a separation of the Chairman and CEO roles at Datascope and other measures to provide greater accountability and transparency.

Management views and responses:

Management criticized Ramius Group as being nothing more than "a short-sighted hedge fund that did not own a single share in Datascope until less than three months ago." It argued that Ramius had no business plan or vision for the company, that its criticisms of the company's performance were unwarranted and that its claims of governance deficiencies by senior management were uninformed and misguided. It criticized Ramius' nominees as having little or no relevant experience with Datascope's business, lacking independence and representing only the interests of Ramius, rather than all shareholders. It specifically criticized one of the Ramius nominees, William Fox, saying he had a poor record of corporate performance and governance at other companies and noting that he had been named as a defendant in three lawsuits alleging breach of fiduciary duties. The company also suggested that a 20% investment stake in Kensey Nash Corp. held by Ramius, which Datascope called "a direct competitor," meant that the Ramius nominees had a conflict of interest.

The company said that it had a proven track record of performance, including thirty five years of profitability, strong cash flow generation, healthy dividend payments and a strong balance sheet. The company said its robust R&D pipeline, including nine new products delivered in fiscal 2007, was poised to deliver strong revenue growth. It noted that its strategic plan was focused on growth, including investments and acquisitions related to its core businesses and the divestment of non-core assets. Datascope also said that it had recently strengthened its senior management team through the creation of a COO position and the promotion of Dr. Antonio Laudani to that position.

Regarding governance and the board, the company said its board consisted entirely of respected and proven business leaders who had a working understanding of the medical devices industry. It noted that its board consisted of a majority of independent directors, that the board had a designated lead director and that all key committees were comprised solely of independent directors.

Three days prior to the company's annual meeting, Datascope, likely with knowledge that the vote was not going its way in the proxy fight, announced a series of significant corporate governance reforms. The board agreed to terminate the company's poison pill, which was set to expire on June 2, 2011, on or before the 2008 annual meeting of shareholders. In addition, the board pledged not to adopt another shareholder rights plan without first obtaining the approval of a majority of shareholders. In addition, the company agreed to separate the Chairman and CEO roles and to adopt as a corporate governance guideline a goal that 75% of the directors be independent.

Factors in the contest and outcome:

Two of the major proxy advisors, RiskMetrics (then ISS) and Proxy Governance, criticized aspects of the company's corporate governance and performance and recommended that Datascope shareholders support one of the dissident nominees, David Dantzker, but not the other dissident, William Fox. A third advisory firm, Glass Lewis, criticized Datascope's governance but supported the company's nominees.

At the company's annual meeting on Dec. 20, 2007, Dantzker was elected to the board for a three-year term with approximately 7.8 million shares voted for his nomination. Both of the management nominees received approximately 5.7 million shares voted for them, with James Loughlin edging out William Asmundson for the second available board seat. Asmundson had been a Datascope director for 38 years and was the designated lead director. The other dissident nominee, William Fox, received approximately 3.2 million shares voted in favor of his nomination.

Company changes and actions after the contest:

Datascope bought and sold several businesses during 2008. On May 14, 2008, it closed the sale of its patient monitoring business and portions of its global technical services business to Mindray Medical International Limited for $240 million. In June, it announced that it had exercised an option to acquire the peripheral vascular stent business of the Sorin Group in Milan. On Aug. 7, 2008, the company closed the sale of its vascular closure business to St. Jude Medical for approximately $24 million. Finally, on Nov. 26, 2008, the company announced an agreement to sell its endoscopic vessel harvesting product line to Sorin Group for an undisclosed amount.

In June 2008, Datascope announced it was exploring strategic alternatives and on Sept. 15, 2008, it entered into an agreement to merge with Getinge AB and DaVinci Merger sub., whereby each common share would be entitled to receive $53.00 cash. The merger was structured as a tender offer and, as part of the merger agreement, Datascope granted the purchaser an irrevocable option to purchase enough newly issued Datascope shares, at $53.00 per share, to consummate a "short form" merger under Delaware law – provided that at least 80% of shares were tendered. The merger agreement provided that, upon consummation of the merger, Datascope CEO Lawrence Saper would receive a payment of $26.5 million and other benefits.

Ramius continued to purchase shares in the company after gaining a seat on the board and by Sept. 12, 2008, it had raised its stake in Datascope to more than one million shares, or a 6.6% stake.

Situation at year-end 2008:

While it is not entirely clear what would have happened in the absence of the proxy contest by Ramius, it seems likely that its activism and the outcome of the contest played a substantial role in both the governance changes and subsequent decision to explore strategic alternatives that eventually led to the sale of Datascope. As of Jan. 13, 2009, approximately 93% of Datascope's shares had been tendered to Getinge and the purchaser had announced an extension of the tender offer to Jan. 21, 2009. Most of Ramius' early stock purchases were made at approximately $35 per share. At the tender offer price of $53 per share, those early stock purchases will generate a return in excess of 50% over the 16 month period from October 2007 through January 2009, even as the major stock market indices suffered substantial losses during this period.

Going Down With the Ship: WCI Communities, Inc.

As noted earlier in this study, hedge funds planning to run proxy contests focus on companies that they believe are undervalued, but where a catalyst for unlocking additional value, such as changes in management, strategy or capital structure, are apparent. They typically target companies that have underperformed, where shareholders are restless and where business conditions may be poor at present but are likely to improve. Judging a bottom in a poorly performing company or industry, however, is a tricky business – even for highly experienced investors. This proved to be the case for Carl Icahn when he decided that he could help turn things around at ailing homebuilder and real estate company WCI Communities in late 2006.

Proxy contest background and company situation:

Founded in 1946, WCI Communities, Inc. and its subsidiaries operate as an integrated homebuilding and real estate services company. The company designs, constructs, and operates leisure-oriented and master-planned communities; and designs, builds, and sells traditional homes serving primary, second, and retirement home buyers. WCI also designs, builds, and sells luxury residential towers and condominium hotels targeted to primary and affluent, leisure-oriented home purchasers. Its real estate services include realty brokerage, title insurance and closing services, and mortgage banking services. In addition, the company develops and operates amenity facilities, sells selected land parcels, and enters into real estate joint ventures. WCI Communities has operations in more than 60 locations in Florida, New York, New Jersey, Connecticut, Massachusetts, Virginia, and Maryland.

In the year leading up to the proxy contest, the company experienced a significant decline in net income, earnings per share, new orders, and revenue. As a result of the company's lagging stock performance, the company announced a two million-share buyback, which was later revised to five million shares. Shortly thereafter, Moody's Investors Service issued a press release announcing that it had downgraded the ratings of the company, including its corporate family rating to B1 from Ba3 and the ratings on its senior subordinated notes to B3 from B1.

Icahn Partners initially began building its position in August 2006, and by December 2006, owned 5.03%, at which time he expressed to the board an interest in acquiring the company. The board turned down Icahn's proposal stating that market conditions were poor and that the company would fetch a higher bid from a strategic buyer when market conditions improved. On Jan. 16, 2007, Icahn publicly announced that he had increased his position by 3.9 million shares to control 14.57% of the shares outstanding, which resulted in the company's shares jumping 6.9% to close at $22.47 per share. Following Icahn's announcement, the board met and decided to adopt a limited-duration shareholder rights plan with a 15% trigger, which was later revised to 20%, to give the board time to explore alternatives that could maximize shareholders value.

In February 2007, the board offered Icahn a seat on the board in return for his agreement to enter into a one-year standstill agreement preventing Icahn from increasing his position. Icahn agreed to the terms, but only if the company waived the application of Section 203 of Delaware's General Corporation Law, which restricts business combinations with 15% or more shareholders for three years. The board was unwilling to concede to this.

On Feb. 12, 2007, the company announced that it had retained Goldman Sachs & Co. to assist in evaluating financial, strategic, and operational alternatives, and would identify certain assets to sell to reduce the company’s debt. The company also announced a strategic plan to maximize cash flow, reduce overhead expenses, lower direct construction costs and operate more efficiently through the challenging market conditions. Four days later, Icahn launched a proxy fight against the management slate of directors, nominating his own slate of 10 directors to the board. In addition, Icahn announced his intention to commence an unsolicited tender offer to acquire any and all of WCI’s outstanding common stock for $22.00 per share, subject to due diligence and conditioned on the company’s removal of the poison pill.

Following this announcement, Sandell Asset Management Corp., beneficial owner of 9.8% of WCI's common stock, stated that it supported “Icahn's efforts to create change at WCI by nominating and electing an alternative slate of directors at the WCI annual meeting,” and saw his recent tender offer as “a positive step in value maximization at WCI.” It was also pleased with the board’s decision to retain Goldman Sachs to advise the company on strategic alternatives, but stated that if the process did not yield a higher value, it encouraged the board to work with Icahn “toward a negotiated deal rather than attempt to hide behind the recently adopted poison pill. Failure to do so would most likely result in an ignominious exit for the current management and board of directors as well as a potentially less than satisfactory result for shareholders.” Basswood Partners LLC made a similar comment to the company in 2006. In a 13D filing, Basswood stated that WCI had “failed to capitalize on the dramatic growth and profitability expansion experienced by the public homebuilding industry,” and recommended selling the company for a premium to a larger, better capitalized and more profitable homebuilding company. Basswood also criticized the company for agreeing to pay Citibank, N.A., approximately $25 million for an option contract to repurchase five million shares of the company's stock, instead of using this cash to reduce high debt levels.

On May 21, 2007, Icahn’s tender offer expired and Icahn suggested that the board should reschedule the annual meeting after the board expressed concern that the election of Icahn’s slate of directors could hinder the sale process. The board rejected Icahn’s idea, stating that it would determine the timing of its meeting based on its assessment of the best way to maximize shareholder value. On June 6, 2007, Icahn entered into an exclusivity agreement with the company, permitting him to participate in the bidding process. The company adjourned the meeting from June 15, 2007, to Aug. 30, 2007, to allow potential purchasers to continue their due diligence in the company's sale process, and so that the company would be able to provide shareholders with additional information on the sale process prior to the time when they would vote for directors.

Dissident profile and background:

Beginning in 1978, Icahn began taking control positions in individual companies which have included: RJR Nabisco, Texaco, Phillips Petroleum, Western Union, Gulf & Western, Viacom, American Can, USX, Marvel, Imclone, Federal-Mogul, Kerr-McGee, Medimmune, BEA Systems and Time Warner. Icahn became chairman of Bayswater Realty & Capital Corp. in 1979; and chairman of ACF Industries, Inc. in 1984 among others.

Today, Icahn is chairman of Icahn Enterprises, a diversified holding company engaged in a variety of businesses, including investment management, metals, real estate, and consumer goods. He has been the chairman of American Railcar Industries since 1994 and a director of Blockbuster since May 2005. In addition, Icahn became chairman of ImClone Systems in 2006 and of Federal-Mogul in January 2008. Icahn engaged in a total of six proxy fights between 2005 and 2008 which resulted in hybrid boards, including the one with WCI. In 2005, Icahn won a proxy contest and put three nominees, including himself, on the board at Blockbuster due to Blockbuster's failure to acquire Hollywood Entertainment Corp. in 2004. In 2006, Icahn settled a proxy contest with ImClone Systems, Inc. in an agreement which put him and three of his recommended candidates on the management slate. Also in 2006, Icahn settled a proxy contest with Time Warner Inc., over performance concerns, in which Time Warner agreed to allow two directors onto the board at the discretion of Icahn and other major shareholders. In 2008, Icahn settled two proxy contests with Motorola and Yahoo, in which two and three of his nominees were seated, respectively.

Icahn initially solicited proxies to elect himself along with nine other nominees to the WCI board. The three WCI nominees that were seated on the WCI board after settlement were Icahn, Keith Meister and David Schechter, both of whom serve as executives at Icahn affiliates.

Dissident agenda and views:

Icahn recommended his slate of nominees because he believed the board had failed to maximize the company's value and questioned whether the board had the ability or expertise to take advantage of strategic opportunities. For example, Icahn stated that the board was "destroying the value of the company by selling its land to reduce debt covenants," which subsequently reduced the intrinsic value of the company. To Icahn, this was a clear indication that the board did not understand how to maximize shareholder value. Icahn also stated that he believed that "the board and CEO of WCI have not enabled the company to maximize the potential of its unique set of assets which trade at a discount to their GAAP book value." He stated that if elected to the board he would "ensure these unique assets are properly marshaled through the current residential housing industry downturn."

Icahn noted that the company traded significantly below its GAAP book value, which was once $23.19 per share, but was deteriorating. He stated that his tender offer would "provide immediate liquidity at a premium for those shareholders who are concerned with the current housing industry downturn while providing the opportunity for those shareholders who believe in the long-term prospects to realize any potential upside."

Icahn also recommended that the board postpone its meeting to elect the company's slate of directors for at least 30 days. He believed that delaying the meeting would provide interested parties time to conduct due diligence, thereby creating certainty for shareholders that the board was properly fulfilling its duties in maximizing shareholder value. If the board failed to find a bidder, then Icahn would recommend that shareholders vote against the management slate of directors at the postponed meeting. Icahn believed that it should ultimately be up to shareholders– not the board – to determine if an offer from an interested party was fair.

Management views and responses:

The board believed that Icahn's $22.00 per share tender offer did not recognize the value of the company's extensive and well-positioned real estate assets nor its significant brand reputation. In addition, it noted that Icahn's offer was highly conditional, containing 14 conditions in total, which created significant uncertainty that the offer would be consummated. Furthermore, the company said that Icahn's slate of directors presented a conflict of interest because the majority of his slate were Icahn insiders and not independent. The board believed that Icahn's slate of directors would give Icahn preferential treatment and not foster an auction process where all interested parties would participate equally.

The board initiated a comprehensive sale process designed to maximize value for shareholders, and welcomed Icahn's participation as a bidder. The board believed that under other circumstances, a sale might not have been the preferred alternative, but Icahn's disruptive, "structurally coercive" offer caused the board to choose to explore this alternative.

Factors in the contest and outcome:

All three of the major proxy advisors, RiskMetrics (then ISS), Glass Lewis and Proxy Governance, recommended that WCI shareholders re-elect the incumbent board and not vote for any nominees on the dissident slate.

On Aug. 20, 2007, WCI and Icahn announced that they had agreed to a new composition for the WCI board which was be submitted to shareholders for approval at the annual meeting on August 30, 2007. As part of the agreement, Icahn withdrew his competing slate of nominees, ending the proxy contest. Under the terms of the agreement, WCI nominated three candidates: Icahn, Keith Meister and David Schechter. In addition, WCI and Icahn agreed to nominate three additional independent directors: Craig W. Thomas, a portfolio manager at S.A.C. Capital Advisors, LLC; Nick Graziano, a managing director of Sandell Asset Management Corp.; and Jonathan R. Macey, a Yale Law professor. Icahn agreed to vote his shares in favor of this slate of nominees for the board. The agreement reduced the size of the board from 10 to 9 directors: three incumbent WCI directors, three Icahn nominees, and three new independent directors jointly chosen by

WCI and Icahn. The company also instituted a temporary bylaw amendment requiring 8 of the 9 directors to approve any increase or decrease in the size of the board. Finally, the company agreed to disclose all non-public information that it had previously provided to the Icahn parties.

Company changes and actions after the contest:

The company struggled throughout 2007, with some turnover in management and received a "going concern" statement from its auditors in year-end financial statements. Thomas resigned from the board in February 2008 and, on June 13, the board formed a special committee to evaluate restructuring alternatives and hired Lazard Freres to assist it. The company filed for Chapter 11 bankruptcy on Aug. 4, 2008, and its common stock was delisted. At the same time, the company's CEO and the head of its Nominating and Governance Committee resigned. On Aug. 14, one of the Icahn directors, Schecter, resigned and was replaced by Vincent Intrieri.

Situation at year-end 2008:

Since the company delisted from the NYSE, its stock price has declined in value by an additional 95.2%. Icahn and a group of his affiliates have since sold the bulk of their WCI Communities common stock for $0.02 – total – to an unidentified buyer, who was reportedly buying the shares for investment, not for control, according to a Dec. 5, 2008, filing with the SEC. One source reported that he thought the Icahn sales were made to establish a 2008 tax loss. Icahn said in the filing that he still owns or beneficially controls just 3,848, or 0.01%, of the more than 53.2 million shares outstanding. Both Icahn and Meister remain on the board.

"I expect that WCI, when it emerges from bankruptcy, to be obviously a much smaller developer, with ownership in the hands of the current debt holders," said real estate analyst Jack McCabe, CEO of Deerfield Beach-based McCabe Research and Consulting. "I can't imagine the common shareholders will get anything." WCI's stock closed at $0.06 per share on Jan. 28, 2009.

Through the Looking Glass: Take-Two Interactive Software Inc.

In 2007, TakeTwo Interactive Software, after suffering through years of declining corporate performance and accounting issues, was the target of a proxy contest by a group of hedge funds which collectively controlled 46% of the company's stock, and which ran a full slate seeking control of the board for both performance and governance issues. The need for change was so compelling the five dissident directors were joined by two incumbent directors as members of the dissident slate, making the resulting hybrid board – unlike many others in the study group – overwhelmingly like-minded. The mandate for change which swept the hybrid board into office, however, seems to have been converted into actions which produced precious little, if any, advantage for shareholders over the succeeding year.

Proxy contest background and company situation:

Take-Two Interactive Software, Inc. is a global publisher, developer and distributor of interactive entertainment software, hardware and accessories. The company operates in two segments: publishing and distribution. The publishing segment consists of Rockstar Games, 2K Games, 2K Sports and 2K Play publishing labels. The company develops, markets, and publishes software titles for gaming and entertainment hardware platforms, including Sony's line of PlayStation systems; Microsoft's Xbox; Nintendo's Wii and DS systems, as well as for personal computers and games for Windows. The company's distribution segment, which includes its Jack of All Games subsidiary, distributes its products, as well as software, hardware and accessories produced by others to retail outlets in North America. Grand Theft Auto, a controversial video game criticized by some for its violence and content, has historically accounted for a substantial portion of the company's revenues – approximately 22%, 38% and 34%, of the company's total revenue in 2006, 2005 and 2004, respectively.

While the company was profitable from 2002 through 2005, it incurred a significant loss in fiscal 2006. The company stated in its Form 10-K for 2006 that it expected to continue to incur losses until it generated sufficient revenue to offset the increased costs associated with product development and licensing commitments as it diversified its product offerings and transitioned to next-generation platforms. In addition, as described below, options backdating issues at the company resulted in litigation, regulatory proceedings and government enforcement actions – including several derivative complaints and a class action complaint filed against the company's directors and executive officers. The company has also restated certain previously filed financial statements.

OppenheimerFunds, Inc., D. E. Shaw Valence Portfolios, L.L.C., S.A.C. Capital Management, LLC and Tudor Investment Corp. (the "shareholder group"), who controlled approximately 46% of the company's outstanding shares, sought to obtain control of the board in March 2007 by voting the shares they controlled in favor of seven candidates agreed upon by the group – including two management nominees. This followed the significant decline in the company's performance, investigations by the SEC and the New York District Attorney's office, a finding that the company's former CEO was involved in option backdating at the company, and the financial restatements. Due to the option backdating issue, the company was late in filing its 10-K for the 2006 fiscal year, and therefore late in holding its annual shareholders' meeting; the company held an annual meeting in March 2007 that served as the company's annual meetings for both 2006 and 2007.

Dissident agenda and views:

Each of the members of the shareholder group originally acquired shares in the company for investment purposes. Following the release of the company's proxy statement at the end of February 2007, the members of the group held a series of meetings to discuss issues regarding the company, including that the company had posted losses for the past four quarters and restated eight years of financial results due to the stock option backdating. On March 4, 2007, the shareholder group entered into a written agreement, along with ZelnickMedia Corp., and formed a group for SEC reporting purposes. ZelnickMedia is a group of executives who provide management services and expertise to media enterprises – the firm advises, manages and operates companies seeking strategic advice, turnaround management, consolidation and buildup expertise.

Under the agreement, each member of the group voted the shares under their control in favor of the election of candidates agreed upon by the group (originally six, but increased to seven on March 16). ZelnickMedia recommended the candidates to the group (one of which was recommended originally by OppenheimerFunds). The group intended to nominate its seven candidates from the floor at the annual meeting. Because the group controlled 46% of the voting power in the aggregate, it was expected to have sufficient votes to elect its slate without significant additional shareholder support.

Management views and responses:

On March 19, 2007, the company announced the postponement of its annual meeting from March 23 to March 29. The purpose of the board's action was to provide additional time to review the proposed actions of the shareholder group and also to evaluate alternative courses of action that could potentially be presented to the shareholders, including a possible sale of the company. An additional objective of the board was to insure that shareholders, including the shareholder group, not take any action that would preclude an evaluation of any alternative that the company might develop and that could potentially be presented to shareholders.

Factors in the contest and outcome:

On March 29, 2007, Take-Two announced that shareholders elected the dissident slate of directors to the board which included, Strauss Zelnick, Ben Feder, Jon J. Moses, Michael Dornemann, Michael James Sheresky and John Levy, who was an incumbent independent director of Take-Two. Grover C. Brown, another incumbent independent director, was also elected at a meeting of the new board held following the stockholders' meeting. As a result of the board takeover, the company entered into a management agreement with ZelnickMedia and the company named Zelnick executive chairman, Feder as CEO and Lainie Goldstein as CFO.

Company changes and actions after the contest:

Nearly one year after the hybrid board was seated, on Feb. 24, 2008, Electronic Arts, Inc. (EA) announced that it had proposed to acquire the company for $26.00 per share, a premium of 64% over the company's closing stock price on Feb. 15, the last trading day before EA submitted its proposal confidentially to the board. The company confirmed receipt of the proposal by publicly rejecting it as undervalued, and reiterated key features of its turnaround plan, which it contended held stronger opportunities for increasing shareholder value. On March 13, 2008, EA made a tender offer to shareholders to purchase all of Take-Two's outstanding shares for $26.00 per share. On March 24, 2008, the company announced that it had adopted a new rights plan (poison pill) in response to the tender offer made by EA. The company stated that the pill was adopted to allow the board time to explore strategic alternatives and to wait for the release of the highly anticipated "Grand Theft Auto IV." The annual meeting was postponed from April 10, 2008, until April 17, 2008.

EA amended its tender offer to include a condition requiring that either the company's board redeem the preferred stock purchase rights issued as a result of the poison pill or that the rights be invalidated or otherwise made inapplicable to EA's acquisition of the company. In addition, EA extended its tender offer to April 18, 2008, the day after the annual meeting.

According to a number of equity analyst reports compiled by Reuters around the time the tender offer was announced, analysts believed the offer price was fair after taking into account the company's earnings outlook for 2008 and the anticipated release of "Grand Theft Auto IV" on April 29, 2008. Analysts generally believed a deal would go through at $26.00 to $28.00 per share. EA extended its tender offer several times, but never got more than about 15% of shares to tender. The offer was allowed to expire on Aug. 18, 2008, after EA entered into a confidentiality agreement with Take-Two to participate in its strategic review. The company announced on Oct. 2, 2008, it had concluded its review of strategic alternatives, and that the board had determined it would be best for the company to continue operating as a stand-alone entity.

Situation at year-end 2008:

As of Feb. 9, 2009, the company's stock trades below $8.00 per share, representing a 63% decline since EA terminated discussions with Take-Two on Sept. 14, 2008; a 50% decline since the company ended its strategic review process on Oct. 2, 2008; and a 34% decline since the company announced a disappointing earnings outlook on Dec. 17, 2008, of a loss of $0.70 to $0.85 per share for the period ending in January 2009 – significantly lower than the $0.29 per share profit that analysts had anticipated.

Tag-Team Dissidents: Topps Co.

"Strength in numbers" doesn't necessarily ring true in proxy fights. During the 2005-2008 period, a number of contests were tag-team efforts by multiple hedge funds, often to sell the target company. In some cases, activist efforts by one or two funds would unleash "wolf packs" of hedge funds pouring into the company's stock and packing the shareholder base, adding further momentum to the challengers' cause. But as evidenced at Topps Co., even multiple dissidents, galvanized by the tacit or not-so-tacit backing of other funds and proxy advisor sympathizers, can end up with disappointing results after years of relentless pursuit of their objectives.

Company and dissident profiles

The Topps Co. was founded in 1938 by the Shorin brothers (Philip, Abram, Ira and Joseph) as Topps Chewing Gum, maker of the popular Bazooka bubble gum and, in the 1950s, baseball trading cards. The confectionery and entertainment businesses expanded over the years to include other novelty candies, stickers, albums and collectible strategy games. Topps Chewing Gum went public for the first time in 1972, returned to private ownership in 1984 under a leveraged buyout and went public again in 1987 under its new name, The Topps Co. Throughout these changes, the Shorin family retained management control of the company and was headed from 1980 onwards by Arthur Shorin, son of founder Joseph Shorin, who owned 7.3% of the company's stock.

Pembridge Capital Management LLC is an investment management firm that mainly invests in undervalued, small-capitalization companies. Its Pembridge Value Opportunity Fund LP is a deep value hedge fund that follows an activist approach, working with managements of portfolio companies to improve value. Timothy Brog has been president of Pembridge Capital and portfolio manager of the fund since 2004. In addition to Topps, Pembridge was active at Peerless Systems Corp. in 2007.

Also an activist hedge fund, Crescendo Partners, L.P. was founded in 1998. Its principals, Eric Rosenfeld (CEO) and Arnaud Ajdler (managing director), engaged in proxy fights from 2005 to 2008 at Geac Computer Corp. Ltd., Computer Horizons Corp., O'Charley's Inc. and Charming Shoppes Inc.

First proxy fight and settlement – 2005

In 2004, Topps faced significant challenges in both its confectionery and entertainment units, prompting the company to engage an outside consultant to conduct a strategic review. The sports trading card segment had been experiencing a steady decline since the 1990s with industry sales trending down over the previous five years at an annual rate of 15% -- the result of a proliferation of products and higher prices causing a loss of young consumers and casual collectors. Sales from the candy business were also stagnating while overhead and marketing were increasing. In view of the competition and market consolidation in the confectionery industry, Topps began an effort in early 2005 to auction that business.

During the sale process, which was not publicly disclosed until May 2005, Pembridge launched its first proxy fight, with the objective of selling all or part of the company, spinning off either the candy or entertainment business, or returning cash to shareholders through a stock buyback or special dividend. Pembridge began buying into the stock in July 2004, seeing it as undervalued, and criticized the board for overseeing five years of a declining share price, misuse of the balance sheet, poor corporate governance and excessive executive compensation.

On June 9, three weeks before the 2005 annual meeting, Pembridge agreed to withdraw its nominees (Brog, Mark Shapiro and James Westphal) after learning that Topps had hired Lehman Brothers Inc. in February to explore a sale of the confectionery business. The company also agreed to not adopt a poison pill for a year without shareholder approval.

Second proxy contest – 2006

By September 2005, Topps' settlement with Pembridge appeared to be no more than a “head fake” defense when the company announced that it had terminated the sale process after failing to attract adequate offers in favor of a restructuring plan.

With its standstill concluded at the end of 2005, Pembridge initiated a second proxy contest in April 2006, this time with Crescendo (“The Topps Full Value Committee”). Crescendo bought its shares only that month and, together with Pembridge, owned 7.4% of the stock. The dissident nominees—Brog, Ajdler and John Jones (a consultant to Trump Entertainment Resorts and formerly an executive with Argosy Gaming Co. and RCN Corp.)--continued to press for a sale of all or part of the company.

As in 2005, the dissidents admonished Topps' five-year decline in share price (39%), increase in SG&A (30%) and decrease in income from operations from $36.6 million to a loss of $2.3 million. At the same time, the company had maintained sizable cash and short-term investments ($103 million on average, representing 35% of annual sales), which could be redeployed or returned to investors. Weak governance factored as a complaint as well: an entrenched leadership (combined chairman/CEO Sorin, son-in-law Scott Silverstein as president, and various board member relationships), excessive executive compensation and multiple takeover defenses—two of which the dissidents proposed dismantling to facilitate future contests (declassifying the board and allowing holders of 15% or more of the stock to call special meetings).

Although the company had made progress in restructuring the businesses, cutting costs and recruiting new senior executives, its actions were regarded as too little, too late. Market analysts maintained that that the candy and entertainment divisions should be separated, while the company's aborted sales process and lumbering execution of its strategic plan -- in which the confectionery segment hinged on the success of a new candy product and the re-launching of its 60-year-old Bazooka bubble gum -- convinced three proxy advisors (RiskMetrics Group, Glass Lewis & Co. and PROXY *Governance,* Inc.) to support the dissidents.

Proxy advisor opinions weren't the only factor swaying the outcome of the fight. According to May 2006 press reports, 12 hedge funds had purchased Topps shares in the months before the annual meeting, creating a significant shift in the shareholder base. With the shareholders' meeting pushed to late July, Brog himself observed, “The longer time goes by, the more event-driven hedge funds will get involved.”

Presumably facing a real possibility of defeat, Topps compromised with the dissidents immediately prior to the annual meeting by agreeing to expand the board from nine to 10 members and recomposing the management slate with three dissident nominees and CEO Sorin. The company also conceded to amending the certificate and bylaws to declassify the board and allow holders of at least 25% of the shares to call special meetings (the latter becoming effective after the 2007 annual meeting).

Third proxy fight—2007

Following the 2006 settlement, there was a general belief in the marketplace that Topps would entertain sale offers. It did, in fact, receive unsolicited indications of interest ranging from $9.00 to $10.00 per share from two financial buyers and from Madison Dearborn Partners LLC/Tornante Co. LLC, a private investment company controlled by former Walt Disney Co. CEO Michael Eisner. Negotiations, however, were put on hold until the fall of 2006 so the board could reconstitute its strategic review committee to include two dissident directors (Brog and Ajdler) and two incumbents (Stephen Greenberg and Allan Feder).

From the outset, the committee appeared bitterly divided over how to best follow up with the interested parties and what other strategic alternatives to consider. The dissident directors favored a special cash dividend and insisted that a public auction be undertaken if talks were to continue with Eisner and other interested parties. The incumbent directors, both on the committee and on the board, opposed a public auction out of concern that Eisner would walk away and higher bids might not emerge—and a failed public auction would in turn damage the restructuring process.

With the dissident directors outnumbered, the board approved a $9.75/share cash offer ($378 million) by Eisner, a mere 9% premium to the stock price before announcement, though with a 40-day go shop period. During this time, 107 potential strategic and financial buyers were contacted and one made a serious offer of $10.75/share—sports card competitor The Upper Deck Co., which had approached Topps during the 2005 sale process. Upon the conclusion of the go-shop period in May 2007, the board spurned Upper Deck's offer, claiming it was not superior to Eisner's due to an absence of financing information, Upper Deck's unwillingness to bear anti-trust risk and a low ($12 million) termination fee. Upper Deck proceeded to launch a non-coercive $10.75/share tender offer, but ultimately withdrew it prior to the Aug. 30, 2007, special shareholders' meeting (later postponed to Sept. 19) when continued discussions with Topps remained at an impasse.

Meanwhile, dissident director Ajdler and Crescendo formed The Committee to Enhance Topps to solicit proxies in opposition to the merger for undervaluing the company (the offer price by then was below Topps' trading price) and for a flawed decision process, including the board's unwillingness to deal fairly with Upper Deck, its disregard for the opposition expressed by the dissident directors and apparent bias towards the Eisner transaction under which Topps management was guaranteed jobs. If voted down, Ajdler, Brog and Jones intended to nominate an alternative slate of 10 directors at the next annual meeting, normally be held in September. With the sale effort concluded, the dissidents shifted their platform to advocating a modified “Dutch Auction” tender offer to buy back $110 million shares (about 28% of the stock) at $10.00-$10.50 per share and improving operations, including overhauling senior management and replacing the CEO with a marketing and turnaround expert. By the dissidents' optimistic estimates, operational improvements could yield a two-year enterprise value of $16.00 to $18.00 per share.

As in 2006, three proxy advisors (RiskMetrics, Glass-Lewis and PROXY *Governance)* lent their support to the dissidents and opposed the Eisner deal. A fourth proxy advisor, Egan-Jones Proxy Services, backed the merger, as did activist fund manager Mario Gabelli (Gamco Investors Inc.), who had ratcheted his stake to 8.5% by mid-September. The merger, which offered only a 9% premium to the “undisturbed” share price, was ultimately approved by shareholders in a close vote and consummated on Oct. 12, 2007.

Long and contentious proxy battles can have disappointing finales for dissidents, even when propelled by a tail wind of support. Tenacious to the end, Crescendo, for its part, announced the day of the special meeting it would assert appraisal rights for its 6.6% stake, perhaps in a bold last attempt to derail the deal (Eisner could walk if holders of over 15% of the shares exercised such rights) or perhaps to simply try to collect a higher value for its shares. As for Eisner, he has big plans for Topps: “Bazooka Joe is my new Mickey Mouse.”

The Return of the King: Vineyard National Bancorp

Sometimes the battle over "shareholder value" comes to seem more a vehicle for settling personal and professional scores, particularly when exiled executives, deposed directors or feuding founders and their families resurface as dissidents. In these cases, personal disputes with the incumbent board can turn into public power struggles, and matters of business strategy and direction become muddied in "bad blood" tussles. But in some cases - particularly when the company has slipped into a crisis of its own – the rallying cry of the former leader, campaigning as the hero who can rescue the company from its travails, inspires substantial shareholder enthusiasm which an incumbent board and management team can rarely inspire.

Company background:

Vineyard National Bancorp (VNBC) is a $2.5 billion bank holding company headquartered in Corona, California in the Inland Empire region east of Los Angeles. Its subsidiary, Vineyard Bank, National Association, was established in 1981 as a community bank serving the needs of individuals, small businesses, commercial and residential real estate developers, and local public and private organizations with a focus on building long-term relationships with customers. VNBC operates 16 full-service banking centers and four regional financial centers in the California counties of Los Angeles, Marin, Orange, Riverside, San Bernardino, San Diego, Santa Clara and Ventura.

The bank has grown both organically and through acquisitions (Rancho Bank in 2006 and the Exchange Companies--1031 Exchange Advantage, Inc. and 1031 Funding & Reserve Corp.--in 2007), expanding from $110 million in assets at the end of FY 2000 to $2.5 billion in assets at the end of FY 2007, with a strategic focus on high-yielding construction loans. Share performance, however, which had been strong through 2004, began declining in 2006 and accelerated sharply by mid-2007 as a result of the abrupt and severe decline in the real estate and financial markets. At the time of the proxy contest in mid-July 2008, shares had fallen 90% in one year, compared to a 33% decline in the NASDAQ Bank Index.

Although not a subprime lender, the bank had been exposed to the market downturn through its construction and land loan portfolios (50% of the total loan portfolio), particularly its single family tract portfolio, which depended on the borrowing capability of lower and middle income families. Though only about 7% of the total portfolio, the category accounted for over half of the $38.4 million in loan loss provisions reported for fiscal 2007. This loan loss provision and an unrelated goodwill write-down of $41 million from the 2006 Rancho Bank acquisition resulted in a reported net loss of $40 million in 2007, a reversal of $60 million from VNBC's 2006 net profit of $20 million.

Conditions continued to deteriorate into 2008. In its first quarter financials, the company reported an additional $26.9 million in loan loss provisions and a net loss for the quarter of $13.3 million. Shortly thereafter, after failing to raise additional capital, the bank was designated in "troubled condition" by the Office of the Comptroller of the Currency and the Federal Reserve Board, resulting in greater regulatory scrutiny and restrictions on appointing new executives and directors and paying dividends.

Proxy contest background:

Since 2000, VNBC had been headed by CEO and President Norman Morales, who had spent 25 years in community banking at other southern California banks and savings and loans. Due to "irreconcilable differences" over strategy, Morales resigned at the board's request in January 2008, ahead of the fourth quarter earnings announcement. He was replaced on an interim basis by Chairman James LeSieur, a director since 2004.

Although the separation was portrayed as amicable (Morales was slated to continue in a consulting capacity), in mid-February 2008 Morales and investor Jon Salmanson, who together owned 4.1% of the stock, initiated a consent solicitation to enable a proxy contest at the annual meeting, citing a lack of confidence in the company's direction and lack of communication to the investment community. The consent proposals would amend the bylaws to extend the deadline for shareholder nominations to the board (which had passed in mid-December 2008) if a director, CEO or president had left office since the original deadline. Although not endorsed by three proxy advisory firms (RiskMetrics, Glass Lewis and PROXY *Governance*), a majority of shareholders ultimately supported the bylaw changes.

Dissident profile and agenda:

Following the consent solicitation, Douglas Kratz, the chairman and CEO of Texas-based Opportunity Bancshares, Inc. and a holder of 5.2% of VNBC's shares, sent a public letter lambasting the board for laying all of the company's problems at Morales' feet, despite having "enjoyed the ride" as he grew the company. Kratz and Perry Hansen (president of Opportunity Bancshares) had filed a Schedule 13D on Feb. 22, 2008, a few days before Morales filed his preliminary consent solicitation, indicating that they might seek board representation, a change in senior management, a business transaction or a tender offer. Kratz joined the dissident campaign as one of their seven nominees, which also included Morales, Lester Strong (from Lockheed Martin Corp.), Thomas Koss (from The Warmington Group, a private home builder in southern California), Cynthia Harriss (from Gap Inc.), Harice "Dev" Ogle (from Ken Blanchard Cos., a personnel consulting firm) and Glen Terry (from Tri-Valley Bank in San Ramon, California).

The dissident platform centered around continuing Morales' long-term strategy for the firm, which had transformed it into a major regional community bank in the previous seven years. The board, however, became spooked by the unfolding crisis in the housing market in late 2007. To address the market challenges, the board was essentially following a plan Morales drafted prior to his departure in early 2008, which called for:

- Reducing the company's risk profile through a significant reduction of single family residential tract construction lending and land development projects, enhanced borrowing requirements, and enhanced balance sheet management;
- Rebalancing and diversifying the loan portfolio to reduce risk and improve loan

quality and returns;
- Enhancing liquidity, reducing costs by focusing on low to moderate cost deposits and cash management, and reducing reliance on wholesale borrowing; and
- Reallocating and reorganizing personnel resources.

While the dissidents recognized the urgent need to address the bank's liquidity position and the headwinds in the financial and real estate markets, they were not in favor of a wholesale abandonment of the bank's long-term growth strategy. Along with the four objectives above, the dissidents added three other strategic initiatives, creating a seven-point plan that would reduce the bank's risk profile, alleviate its liquidity issues and restore profitability by:

- Restoring capital through supplemental Tier 1 capital and Tier 2 capital increases;
- Improving asset quality by exiting single family tract lending and disposing of completed housing projects in default; and
- Diversifying into alternative operating revenue channels that were less sensitive to interest rate cycles.

Although the single family tract portfolio had been decimated, the dissidents maintained that the remaining loan portfolio could weather the downturn well. Accordingly, lowering the bank's risk profile could be achieved by rebalancing the portfolio rather than shrinking it. This would involve expanding certain opportunities, such as capitalizing on market disintermediation for products, including higher quality luxury construction loans, and eliminating other products, such as single family tract loans.

Management views and responses:

The board's main dispute with Morales was over his aggressive growth strategy, particularly the role played by construction loans and higher cost funding sources, amid what was first a slowing housing market and then a full blown credit crisis. They believed that Morales' preoccupation with growth came at the expense of under-appreciation for the liquidity challenges the bank was facing and the need to conserve capital and minimize additional business risks. In the board's view, the dissident plan to diversify revenues would only add execution risk to an already difficult operating environment, ignored the regulatory limits placed on the bank and would, in all likelihood, grow the balance sheet at a time when it should be shrinking.

In addition to its four strategic initiatives, the company added a fifth objective to protect and preserve capital. Along with shrinking the balance sheet by reducing loan growth and bringing its holdings more in line with its lower cost deposits, VNBC would raise additional capital to address the declines in real estate values and to remedy the "troubled condition" designation. The longer-term plan envisioned a smaller bank with a more traditional community banking loan and deposit profile.

The board was also troubled that most of the dissident nominees had ties to Morales. While Morales was CEO of VNBC, Ogle was a consultant to the company and Terry and Harriss were under consideration for hiring. Hardin had worked with Morales and his wife at another bank, and Strong was previously considered as a director nominee by the Nominating Committee. The board, on the other hand, was "pleased to see" the addition of Kratz to the dissident slate, for whom it had "high regard for his banking experience" and would support as chairman in any settlement.

Factors in the contest and outcome:

Although the board and the dissidents essentially espoused the same game plan for weathering the financial crisis, their divergence in longer-term strategy—growing and diversifying the business versus scaling back—was likely decisive in the contest.

The two sides engaged in settlement talks unsuccessfully. The dissidents proposed a joint slate proportional to the results of the consent solicitation. The board offered majority control to the dissidents as long as Morales wouldn't be one of the nominees. As it ended up, Morales withdrew his nomination on Aug. 4, 2008 (the day before the annual meeting) because he did not receive regulatory approval to serve as VNBC's CEO, president and director. Dissident nominee Koss also bowed out, reducing the dissident slate to five. All five dissident nominees were elected by 72.8% of the shares, with support from PROXY *Governance* (five of the original seven dissidents), RiskMetrics (four dissidents) and Glass Lewis (two dissidents). Incumbents David Buxbaum and Charles Keagle retained their seats.

Company changes and actions after the contest:

Following the dissident win, additional board and management changes continued. Dissident nominee Harriss resigned from the board on Aug. 20 and was replaced by Perry Hansen, chairman of the Vineyard Bank board. LeSeiur, who was voted out at the annual meeting, was brought back as a director, with the board expanded from seven to eight. Dissident nominee Kratz became chairman and in mid-September 2008, Glen Terry, another dissident nominee, was appointed CEO and president.

As turmoil continued in the economy into the fall, the company took immediate actions to find sources of liquidity and capital, having reported a $109.8 million loss for the nine months ended Sept. 30, 2008, resulting from increases in loan loss provisions. In September, VNBC sold the Exchange Companies back to its previous owner. The businesses were originally acquired in the fourth quarter of 2007 to provide a source of low-cost deposits to Vineyard Bank. The company also announced that it would begin a $250 million private placement offering of common stock and convertible senior secured notes. However, after discussions with several private equity firms failed to result in a transaction, the board and its financial advisors explored other strategic alternatives, including a sale of Vineyard Bank. In November, VNBC agreed to sell the bank to Kratz and a private investment group for $18 million, which the board considered the best alternative for strengthening the institution and protecting depositors. Although the company has been publicly silent about its future since the announcement, it may have averted the worst casualties that have befallen the Inland region. Although VNBC shares lost approximately 98% of their value from year-end 2007 ($10.10) to year-end 2008 ($0.15), by early 2009, the severe housing downturn and delinquent residential construction loans resulted in the failure of two other local banks, 1st Centennial Bank and PFF Bank & Trust.

Appendix 2: Methodology

The study examines a hand-collected database of 120 hybrid boards of directors formed at U.S. public companies between 2005 and 2008 when the threat or actual filing of a proxy contest resulted in the seating of dissident and/or additional independent directors. Key objectives of each dissident campaign, as identified in SEC filings, contest fight letters, and other public statements directly attributable to the dissident shareholders themselves, were itemized within the larger categories of strategic, governance, and performance concerns.

A hybrid board was considered "formed," for measurement purposes, on the earliest date a dissident or additional independent director was seated; in instances where that date was not available, the earlier of the contest settlement date or the contested shareholder meeting was used. Company filings, press releases, and news articles were examined for changes (subsequent to the formation of the hybrid board) in governance practices, bylaws, management (including both executives and directors), and announcements of strategic initiatives or agreements (including sale of the company). All 120 companies in the study were evaluated individually, to measure these changes against the explicit dissident campaign objectives, and in aggregate, to identify trends.

Shareholder value, a decidedly non-GAAP measure, is by far the most common field of contention in proxy contests – including those contests at firms outperforming the market and their peers. While clearly it incorporates the cumulative value of past corporate performance, it also – unlike accounting-based metrics – includes a forward-looking component reflecting expectations about the company's future risks and opportunities. As such, the company's share price history (adjusted for splits and dividends) is generally the most robust indicator of changes in shareholder value. Share price histories were gathered for each of the firms which had passed the one-year anniversary of its hybrid board, as well as a control group of 6 to 10 of its peers. Share price performance was measured over the 3 month period prior to, and the 12 and (where possible) 36 month periods immediately following, the formation of the hybrid board. Each company's performance was measured both in terms of absolute improvement or decline for the period, and relative to the average improvement or decline of its peers for the same period.

Results for both the financial and non-financial measurements were aggregated into two broad categories of dissidents – institutional and non-institutional investors – and subdivided within those categories according to certain characteristics of the dissident groups leading the proxy contests through which the hybrid board was formed. For institutional investors, these groupings included individual hedge funds acting as the sole dissident in multiple proxy contests within the study period, individual hedge funds acting as the sole dissident in only one proxy contest within the study period, multiple hedge funds acting as a dissident group, and other, non-hedge fund dissidents. For non-institutional investors, these groups included founders, current directors, former executives or directors, and other non-institutional investors who had never been corporate insiders.

Appendix 3: Compounding of the "Contest Effect"

The single most significant contributor to overall share price performance for a company which seated a hybrid board was the "contest effect," through which an initial share price increase in the three months leading up to the resolution of a contest could provide a meaningful head start versus peers. Any subsequent 12 or 36 month price appreciation under the hybrid board would then be applied against this larger base, compounding its effect. Performance after a hybrid board was seated, therefore, might be only on part with peers – but in aggregate, considering the compounding effect of this performance on the contest period price appreciation, the company might significantly outperform its peers, as the example of Alliance Semiconductor Corp. demonstrates:

Compound Effect of Hybrid Board Performance on "Contest Effect" Share Price Performance

	3 Month Contest Period*	12 Months From Contest	12 Months + Contest Period	36 Months From Contest	36 Months + Contest Period
Change in Share Price (pct)					
Company					
Alliance Semiconductor Corp.	**41.0 %**	**23.3 %**	**73.8 %**	**(84.5)%**	**(78.1)%**
Peers					
Anadigics Inc.	51.5 %	127.0 %	243.9 %	(31.8)%	3.4 %
California Micro Devices Corp.	12.4 %	(21.5)%	(11.8)%	(67.6)%	(63.6)%
Catalyst Semiconductor Inc.	11.6 %	(32.4)%	(24.6)%	6.1 %	18.5 %
Metalink Ltd.	(12.4)%	28.2 %	12.4 %	(94.6)%	(95.2)%
Tower Semiconductor Ltd.	(3.3)%	60.3 %	55.0 %	(69.0)%	(70.0)%
Transwitch Corp.	(34.4)%	5.8 %	(30.7)%	(72.7)%	(82.1)%
White Electronic Designs Corp.	(8.7)%	0.6 %	(8.2)%	(26.5)%	(32.9)%
Avg.Peer Change	**2.4 %**	**24.0 %**	**33.7 %**	**(50.8)%**	**(46.0)%**
Indices					
Russell 3000	**2.2 %**	**7.9 %**	**10.4 %**	**7.6 %**	**10.1 %**
NASDAQ	**(4.0)%**	**13.3 %**	**8.7 %**	**(17.0)%**	**(20.4)%**
S&P 1500	**6.5 %**	**8.9 %**	**16.0 %**	**(25.1)%**	**(20.2)%**
Change in Company Share Price B/(W) Benchmark (pct pts)					
Peers	38.6	(0.7)	40.1	(33.6)	(32.1)
Russell 3000	38.7	15.4	63.4	(92.1)	(88.1)
NASDAQ	45.0	10.0	65.1	(67.4)	(57.7)
S&P 1500	34.4	14.4	57.8	(59.4)	(57.9)

*Standardized for all contests to a 3-month period ending with seating of hybrid board.

- In the three months prior to the seating of its hybrid board in 2005, Alliance Semiconductor saw price appreciation of 41%. Share prices for a group of seven peers, by contrast, increased by an average of only 2.4% during the same period, giving the company a contest effect increase of 38.6 percentage point increase relative to peers.

- Over the 12 months after the hybrid board was seated, however, the company's share price performance was slightly worse than peers. The company's share price increased by 23.3% over the period, which was 0.7 percentage points less than the 24.0% average increase among its peers.

- Because of the compounding effect on the company's significantly higher contest effect share price appreciation, however, even this slightly lower rate of share price appreciation increased the company's performance over the entire 15 month period, to 73.8% after 15 months. Peers, by contrast, gained little from the same compounding effect on a much smaller contest period increase, and posted an average share price increase of 33.7% over 15 month period, or 40.1 percentage points lower than the company's performance for that period.

Despite a slightly weaker relative performance during the 12 months after the hybrid board was seated, therefore, the company increased its performance relative to peers from 38.6 percentage points after the 3 month contest period to 40.1 percentage points over the 15 months from the beginning of the contest period to the 1 year anniversary of the creation of the hybrid board.

The contest effect itself was not necessarily a reliable indicator of sustainable share price performance. Over the three year period following the creation of the company's hybrid board, the company's share price fell 84.5%. This 3 year performance overwhelmed the head start of the contest period itself, yielding an overall 39 month share price decline of 78.1%. Peer share prices, by contrast – which had only minimal gains during the 3 month contest period – declined only 50.8% over the 36 months after the contest period, for a compounded 39 month average decline of 46.0%. As a result, the company's 39 month overall decline of 84.5% was 32.1 percentage points worse than the 46.0% average decline among its peers over the same period.

Appendix 4: Proxy Contests Resulting In Hybrid Boards

NON-INSTITUTIONAL INVESTORS		
Founders		
Alex Mashinsky	Arbinet-thexchange, Inc.	2006
Steve Meyers	SM&A Corp.	2008
Current Execs/Directors		
Ahmed Hussein	Quality Systems, Inc.	2005
Ahmed Hussein	Quality Systems Inc.	2008
Former Execs/Directors		
David Branderberg	Intervoice, Inc.	2007
Jon Salmanson, Norman Morales	Vineyard National Bancorp	2008
Willis J. Duncan	CNB Corp.	2006
Other non-institutional		
Glenn Nussdorf	Parlux Fragrances, Inc.	2007
James W. Sight	Feldman Mall Properties, Inc.	2008
Jan Loeb, Norman Toor	Golf Trust of America, Inc.	2006
Maurice Koury	Cape Fear Bank Corp.	2008
INSTITUTIONAL INVESTORS		
Hedge Funds with Multiple Contests		
Barington Capital Group	Steven Madden Ltd.	2005
Barington Capital Group	A. Schulman Inc.	2005
Barington Capital Group	Lancaster Colony Corp.	2007
Barington Capital Group	Dillard's Inc.	2008
Breeden Capital Management LLC	Applebee's International Inc.	2007
Breeden Capital Management LLC	H&R Block Inc.	2007
Breeden Capital Management LLC	Zale Corp.	2008
Carl Icahn	Blockbuster Inc.	2005
Carl Icahn	ImClone Systems Inc.	2006
Carl Icahn	WCI Communities Inc.	2007
Carl Icahn	Motorola Inc.	2008
Carl Icahn	Yahoo! Inc.	2008
Costa Brava Partnership III LP	Bradley Pharmaceuticals, Inc.	2006
Costa Brava Partnership III LP	TechTeam Global Inc.	2006
Costa Brava Partnership III LP	Bassett Furniture Industries Inc.	2008
Lawndale Capital Management LLC	Mace Security International Inc.	2007
Lawndale Capital Management LLC	Sparton Corp.	2008
MMI Investments L.P.	Brinks Co.	2008
MMI Investments L.P.	Brinks Co.	2008
MMI Investments L.P.	Unisys Corp.	2008
Oliver Press Partners, LLC	Comverse Technology	2007
Oliver Press Partners, LLC	Emageon Inc.	2008
Oliver Press Partners, LLC	Phoenix Companies, Inc.	2008
Ramius Capital Group LLC	SCS Transportation Inc.	2006
Ramius Capital Group LLC	Phoenix Technologies, Inc.	2007
Ramius Capital Group LLC	Datascope Corp.	2007
Ramius Capital Group LLC	A. Schulman, Inc.	2008
Ramius Capital Group LLC	A. Schulman, Inc.	2008
Relational Investors LLC	SPX Corp.	2005
Relational Investors LLC	Sovereign Bancorp Inc.	2006
Relational Investors LLC	Home Depot Inc.	2007
Relational Investors LLC	Sprint Nextel Corp.	2008
Riley Investment Management, LLC	Alliance Semiconductor Corp.	2005
Riley Investment Management, LLC	Silicon Storage Technology, Inc.	2008
Riley Investment Management, LLC	Transmeta Corp.	2008
Riley Investment Management, LLC	Zilog, Inc.	2008
Steel Partners II LP	BKF Capital Group, Inc.	2005
Steel Partners II LP	Angelica Corp.	2006
Steel Partners II LP	Novoste Corp.	2006
Steel Partners II LP	EnPro Industries, Inc.	2008
Steel Partners II LP	GenCorp Inc.	2008
Steel Partners II LP	Point Blank Solutions, Inc.	2008
Third Point LLC	Ligand Pharmaceuticals Inc.	2005
Third Point LLC	Massey Energy Inc.	2006
Third Point LLC	Pogo Producing Co.	2007
Third Point LLC	TXCO Resources Inc.	2008

INSTITUTIONAL INVESTORS (continued)

One Hedge Fund, One Contest

Accipiter Life Sciences Fund, LP	Rural/Metro Corp.	2008
Caxton Associates	InFocus Corp.	2007
CD Capital Management LLC	Sunterra Corp	2006
Crescendo Partners	O'Charley's Inc.	2008
Cyrus Opportunities Master Fund II	Aquila Inc.	2005
D.E. Shaw & Co., L.P.	Endo Pharmaceuticals Inc.	2008
First Union Real Estate Equity and Mortgage Investments	Sizeler Property Investors, Inc.	2005
Flagg Street Capital LLC	Pomeroy IT Solutions Inc.	2007
Golconda Capital Management, LLC	Tandy Brands Accessories, Inc.	2007
Greenlight Capital, L.P.	New Century Financial Corp.	2006
GWA Capital Partners, LLC	Exar Corp.	2005
Harbinger Capital Partners	Media General, Inc.	2008
Hayman Capital Master Fund LP	ExpressJet Holdings Inc.	2008
Henry Partners L.P.	Wegener Corp.	2006
Hovde Capital Advisors	Great Wolf Resorts	2008
K Capital Offshore Master Fund	OfficeMax Inc.	2005
Knightspoint Group	Sharper Image Corp.	2006
Laddcap Value Partners	Delcath Systems, Inc.	2006
Liberation Investments, L.P.	Multimedia Games Inc.	2006
Lion Fund, Western Sizzlin Corp.	Steak N Shake Co.	2008
Loeb Partners Corp.	Spartan Stores Inc.	2005
Metropolitan Capital Advisors	Cyberonics Inc.	2007
Nanes Delorme Partners I LP	Vaalco Energy Inc.	2008
Pershing Square Capital Management	Ceridian Corp.	2007
Pirate Capital LLC	Brinks Co.	2007
PL Capital Group	Synergy Financial Group, Inc.	2006
Sandell Asset Management Corp.	InfoSpace Inc.	2007
Seidman and Associates, LLC	Center Bancorp Inc.	2007
Seneca Capital LP	Reliant Energy Inc.	2006
Shamrock Activist Value Fund	Coinstar, Inc.	2008
Sherborne Investors	Nautilus, Inc.	2007
Strongbow Capital Ltd.	Duckwall-Alco Stores	2008
Tracinda Corp.	General Motors Corp.	2006
Trian Fund Management, L.P.	H.J. Heinz Co.	2006
ValueAct Capital	Acxiom Corp.	2006
Water Asset Management LLC	Insituform Technologies, Inc.	2008
Wattles Capital Management, LLC	Circuit City Stores, Inc.	2008
Wynnefield Group	Crown Crafts Inc.	2007

Private Equity

Sun Capital Partners, Inc.	Furniture Brands International Inc.	2008

Potential Strategic Acquirer

AirTran Holdings Inc.	Midwest Air Group, Inc.	2007

INSTITUTIONAL INVESTORS (continued)

Hedge Funds Acting In a Group

Barington Capital Group LP; Pirate Capital LLC	Pep Boys Manny, Moe & Jack	2006
Bicknell Group; Keith Edquist	Team Financial, Inc.	2008
Caduceus Capital Master Fund Ltd. and OrbiMed Advisors	BioMarin Pharmaceutical Inc.	2005
Carl Icahn, Jana Partners LLC, S.A.C. Capital Advisors LLC, Franklin Mutual Advisers LLC	Time Warner Inc.	2006
Chadwick Capital Mgt., Delafield Hambrecht Inc.	Cost-U-Less, Inc.	2007
Crescendo Partners, Myca Partners	Charming Shoppes, Inc.	2008
D.E. Shaw & Co., SAC Capital Advisors LLC, OppenheimerFunds Inc., Tudor Investment, ZelnickMedia	Take-Two Interactive Software Inc.	2007
Daniel Snyder, Red Zone LLC	Six Flags Inc.	2005
Harbinger Capital Partners, Firebrand Partners	Gateway Inc.	2006
Harbinger Capital Partners, Firebrand Partners	New York Times Co.	2008
Knightspoint Group, Ramius Capital Group LLC, Parche LLC, Admiral Advisors LLC, C4S & Co. LLC	Ashworth Inc.	2006
New Mountain Vantage LP, CalPERS	National Fuel Gas Co.	2008
Pardus Capital Management LLC; Liberation Investments, L.P.	Bally Total Fitness Holding Corp.	2006
Pembridge Capital Management LLC; Crescendo Partners II, L.P.	The Topps Co.	2005
Pembridge Capital Management LLC; Sherwood Advisors LLC; Whitehall Capital Investors LLC	Peerless Systems Corp.	2007
PL Capital, LLC, AMG Investments, LLC	LNB Bancorp, Inc.	2008
Ramius Capital Group LLC, Barington Capital Group LP	S1 Corp.	2006
Scott Galloway; Firebrand Partners, LLC	RedEnvelope Inc.	2005
Spencer Capital Management, LLC and Thesis Capital Management, LLC	Celebrate Express	2006
Steel Partners II LP, Pirate Capital	GenCorp Inc.	2005
The Children's Investment Fund, 3G Capital Partners Ltd.	CSX Corp.	2008
Third Point LLC, Harvest Management LLC and Knott Partners	Nabi Biopharmaceuticals	2006
Trian Fund Management, L.P., Sandall Asset Management Corp., Highfields Capital Management LP, Pershing Square Capital Management LLP	Wendy's International	2006

Endnotes

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[1] The ability to nominate a so-called "short slate" of directors, where shareholders attempt to contest individual seats, rather than the whole slate of directors or, in the case of a staggered board, all of the nominees up for election, became possible only after a 1992 change in SEC regulations, which was part of a number of proxy reforms instituted under then SEC-chair Richard Breeden, currently chairman of activist fund Breeden Partners LP.

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