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

Investor	Company	Year
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

[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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