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Attacks by Activist Hedge Funds

We created the attached checklist to assist our clients in preparing programs to deal with the activist hedge fund phenomenon. Like all such checklists, it is only an *aide memoire* for developing an individual, specially crafted plan for avoiding becoming the target of a hedge fund attack or, if an attack is mounted, dealing with it. Each company should develop its own plan tailored to its circumstances. The plan should, first and foremost, focus on avoiding becoming a target and then on defending against an attack.

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Hedge Fund Attack Response Checklist

The current high level of hedge fund activism warrants the same kind of preparation as for a hostile takeover bid. In fact, some of the attacks are designed to facilitate a takeover or to force a sale of the target. Careful planning and a proactive approach are critical. Failure to prepare reduces a target's ability to control its own destiny.

Response to a hedge fund attack is an art, not a science. It is essential to be able to mount a defense quickly and to be flexible in responding to changing tactics. Companies should consider governance issues sensibly and in light of their particular needs and circumstances. Whatever the market conditions and the state of the law, a target must have effective defenses and must keep them up to date.

This outline provides a checklist of matters to be considered in putting a company in the best possible position to respond to an attack by a hedge fund. This outline is a supplement to our Takeover Response Checklist (February 2005).

Advance Preparation

1. **Create Team to Deal with Hedge Fund Activism**
 - a. Basically the same team as the takeover response team: a small group (2-5) of key officers plus lawyer, investment banker, proxy soliciting firm, and public relations firm
 - b. Ensure ability to convene special meeting of board within 24 to 48 hours
 - c. Continuing contact and periodic meetings are important
 - d. A periodic fire drill is the best way to maintain a state of preparedness
 - e. Periodic updates of board
2. **Shareholder Relations**
 - a. Review dividend policy, analyst and investor presentations and other financial public relations
 - b. Monitor analyst and media reports for opinions or facts that will attract the attention of attackers
 - c. Be consistent with strategic message
 - d. Proactively address reasons for any shortfall in peer company benchmarks; anticipate key questions and challenges from activists, and be prepared with answers

- e. Monitor changes in hedge fund and institutional shareholder holdings on a regular basis; understand the shareholder base, including, to the extent possible, relationships among holders
 - f. Maintain regular, close contact with major institutional investors
 - g. Plan for contacts with media, regulatory agencies and political bodies
3. Prepare the Board of Directors to Deal with the Activist Situation
- a. Maintaining a unified board consensus on key strategic issues is essential to success; in large measure an attack by an activist hedge fund is an attempt to drive a wedge between the board and management by raising doubts about strategy and management performance
 - b. Review basic strategy and evaluation of portfolio of businesses with board in light of possible arguments for spinoffs, share buybacks, special dividends, sale of the company or other structural changes
 - c. Schedule periodic presentations by lawyers and investment bankers to familiarize directors with current activist environment
 - d. Directors must guard against subversion by the activist or related parties and should refer all approaches to the CEO
 - e. Avoid being put in play; psychological and perception factors may be more important than legal and financial factors in avoiding being singled out as a target
4. Monitor Trading
- a. Stock watch service
 - b. Maintain contact with specialist
 - c. Watch for Schedule 13D and Hart-Scott-Rodino Act filings
 - d. Monitor parallel trading and group activity

Responding to an Activist Approach

1. Responses to Non-Public Communications
- a. No duty to discuss or negotiate
 - b. No duty to disclose unless leak comes from within
 - c. Response to any particular approach must be specially structured; team should confer to decide proper response
 - d. Keep board advised

2. Response to Public Communication
 - a. No response other than “will call you back” (no outright rejection; no substantive discussion—try to learn as much as possible by listening)
 - b. Assemble team; inform directors
 - c. Call special board meeting to consider the communication
 - d. Determine board’s response and whether to meet with attacker
 - e. Avoid mixed messages