Legal Giants Wage War Over Role Of Activist Investors (A.K.A. Hedge Funds)

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In one corner there is the brilliant octogenarian Martin Lipton, founder of one of the nation's most powerful and influential law firms, Wachtell, Lipton, which made its name in the giant merger and acquisition battles of the past 4 decades. I guess Lipton has few hedge fund clients because he recently charged the activist hedge funds with "preying on American companies to create short term increases in the market price of their stock at the expense of long term value."

In another corner is Harvard Law Professor Lucian Bebchuk, a prominent expert on corporate governance issues, who has been extolling a recent academic study of 2000 separate interventions by hedge funds into the process of creating "long-term value." Bebchuk believes that "activist hedge funds benefit and do not have an adverse effect on the targets over the five-year period following the attack." Bebchuk also has led the charge against the obscene compensation earned by American CEOs even when their companies do not perform in spectacular growth and profits.

Bebchuk cannot be happy that Lipton recently ripped into him by charging that the Harvard legal eagle has "aided and abetted" activist investors in" a form of extortion." Those tough words recall an earlier hard fought war by the Lipton firm against the so-called "green-mailers" who acquired a position in a major public company, and then made themselves such a bothersome nuisance that the companies decided to buy back their shares at a premium to the market just to get rid of them. As well, Lipton also made himself a useful reputation in defending target companies from hostile takeover by creating so-called "poison-pills," that would trigger the issuance of more securities that would in effect dilute the holding of the raider. A controversial strategy, but effective in some cases.

Personally, I have to say that I've never been enamored by the hedge fund activists who bill themselves as the greatest new heroes in finance capitalism, because I find some too smug, like Bill Ackman, or others like Carl Icahn too insatiable to be multi-billionaire celebrities out to make a killing by showing up establishment management to be duffers requiring his strategic intervention. I'm tired of seeing them on cable tv promoting their positions in Sony, Yahoo, Apple, Herbalife, JC Penney and Sears. It's of little use to ordinary investors. It's more the road to becoming a Monied Celebrity Billionaire.

That said, some of the new breed of hedge fund activists are not acting simply like greedy "greenmailers", out to extort a quick payoff for their own block of shares, and caring little for the widows and orphans who might have tiny stakes. This reasonable middle-ground approach is being taken by that eminent old-time law firm, Sullivan & Cromwell, with whom I have much practical experience and respect for their wisdom.

In an August 22 memorandum sent to me by Sullivan & Cromwell, the firm takes the position that " We believe companies can achieve better outcomes if they avoid … a mindset that

activists… are necessarily bad and must be resisted in the same way… as a coercive tender offer." S & C goes on to say that " In today's environment many investors evaluate their positions regularly, even daily, and arguments about 'short-termism… will not be persuasive to many investors. Instead, companies must present a clear case… to create superior value over some near to medium term time horizon." This will require "better articulation of the long-term effects of a company's current strategy."

Sounding a lot like the Wachtell Lipton governance memos I've read, S & C calls for preparing the board of directors, engaging shareholders and promoting change overall. If you promote change effectively, I guess some raiders won't be needed. Still, the activist investor is here to stay and play a role that is bound to impact share prices. As many boards have shown themselves to be passive ward-heelers for the CEO, there's a role to be played. It's just too bad the mutual funds, the pension funds, the endowments that own a ton of America haven't been more entrepreneurial in pushing for new policies. Boards of directors have not been giants for wealth creation.