

CORPORATE AND SECURITIES LAW

Alert

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Shareholder Activist Developments: The Target - Pershing Square Proxy Fight

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In one of the most closely watched proxy contests of the 2009 season, retailer Target Corporation last week defeated William Ackman's hedge fund, Pershing Square Capital Management L.P., in its bid for five seats on Target's board. Target's successful efforts in fending off this hedge fund challenge followed a prolonged and contentious contest. The following highlights some key issues from the Target-Pershing Square proxy fight that are of note to our public company clients whose investors include hedge funds and other activist shareholders.

The importance of a strong, consistent message. From the outset, Target portrayed Pershing Square's strategic plan for the company as short-sighted, risky and ill-advised. At the same time, Target highlighted the company's financial and operational performance over the previous decade, essentially casting the contest as one between a large retailer with a record of solid long-term performance that was navigating a recession, on the one hand, and a hedge fund desperate to force a short-term rise in the stock, on the other hand.

Pershing Square had proposed that Target restructure and monetize much of its real estate holdings, a common activist suggestion with respect to retail companies – but one that apparently did not resonate with Target's shareholders in the current environment of depressed real estate prices and tight credit. Target portrayed Pershing Square's real estate strategy as risky and speculative financial engineering, necessitated by Pershing Square's desperation to trigger a short-term gain for investors in its heavily leveraged Target fund that had suffered steep declines. Target also characterized Ackman's hedge fund as a short-term opportunist investor by continually pointing to the hedge fund's synthetic equity positions in the company. As a result, in the days leading up to the annual meeting, Ackman found himself on the defensive about his fund's investment motives, to the point that he publicly committed to maintain his personal share of the hedge fund's stake in Target for at least five years if his fund's director candidates were elected.

Importantly, Target was able to demonstrate in its proxy filings that it had engaged in long, thorough and substantive dialogue with Pershing Square regarding its strategic suggestions. In fact, following Pershing Square's suggestion, Target engaged in a \$3.6 billion sale of a stake in its receivables portfolio in 2008. Target also highlighted the fact that its ten-year financial performance reflected well on its board and management, and that the company had engaged and continued to engage in transactions favored by so-called value investors, such as divesting underperforming units, repurchasing shares, and returning cash to shareholders through dividends.

As Pershing Square tried to shift the focus of the contest away from its real estate proposals toward accusations of poor corporate governance at Target, Target strongly defended its governance record and returned attention to Ackman's real estate proposals, which Target maintained were his ultimate goals. It also provided insight to shareholders with respect to its strategy of adding dry, dairy and perishable foods to its retail offerings (which was perhaps a response to Pershing Square's criticism that Target should be run more like Wal-Mart).

We believe that Target positioned itself well for the proxy contest by, from the outset of Pershing Square's investment in the company in 2007, engaging in an active and ongoing dialogue with the hedge fund. This ultimately neutralized the ability of Pershing Square to claim that it was fighting against an entrenched board uninterested in hearing shareholder concerns. We also believe this contest demonstrated that public disputes with activists can often hinge on the ability of the target company to develop and reiterate a clear, consistent message about management's track record and its vision for the company's future.

Effective use of media. Target utilized multiple avenues of communication to deliver its message to investors, including a company Web site dedicated to the annual meeting. Such annual meeting Web sites have been used increasingly by both public companies and activist investors and can be tailored towards specific investor groups, such as mutual funds. Such an annual meeting Web site should be considered by any company facing a proxy contest, because it provides the company with a centralized location from which to broadcast its message, especially when there is almost daily public jousting with dissidents (by our count, there were a total of about 60 written media or SEC communications by Target and Pershing Square during the course of the two-month long proxy fight). Additionally, public companies and activists are increasingly using blogs and other social networking services like Twitter to communicate in real-time as developments unfold. Similarly, companies should consider using Internet monitoring software to track online references to the company in order to stay informed as news develops and to gather a sense of investor sentiment.

Proxy contests and the "universal" proxy card. The Target-Pershing Square proxy contest may serve as a sign of shifting trends in proxy contests with respect to hedge fund tactics and investor voting patterns. The perception that Ackman's hedge fund was a short-term player, reinforced by Target pointing to the hedge fund's derivative position, could lead hedge funds to operate differently. It is possible that we may see more commitments like Ackman's to hold an investment following a successful proxy contest, as well as a decrease in the use of equity derivatives by hedge funds, which can be interpreted as being opposed to long-term shareholder value. Also, while voting advisory firms such as RiskMetrics Group continue to hold significant influence, several of Target's large investors did not follow the recommendations of the large proxy advisory services, including RiskMetrics, which had recommended voting for two of Pershing Square's director candidates. This highlights the need for companies to focus not only on the recommendations of proxy advisory firms but also the voting history of significant investors to determine voting patterns and whether or not they are likely to deviate from recommendations.

The potential impact of shareholder proxy access. Ackman suggested that Target utilize a so-called "universal" proxy card that would allow shareholders to choose among both sides' candidates on the same proxy card. Target rejected this request, citing concerns over shareholder confusion. Such a universal ballot would have saved the hedge fund the printing and mailing costs of sending out its own proxy card and likely would have impacted the voting results in the election of Target's directors by facilitating shareholders' ability to select among candidates on the competing slates. The SEC has indicated that some form of a universal ballot will be a part of the SEC's new proxy access proposal, which we have discussed in our May 15 and May 22 Corporate and Securities Law Alerts. Many commentators agree with Ackman's view that the current proxy rules do not effectively enfranchise shareholders because mixing and matching candidates from competing slates is not possible unless the competing parties agree to allow it.

Bass, Berry & Sims PLC's Shareholder Activism Subgroup monitors and advises on developments in the area of proxy contests, activist campaigns, takeover defense and shareholder communications in the context of the current activist environment. If you have any questions regarding the issues addressed in this Corporate and Securities Law Alert please feel free to contact any of your regular contacts in our Corporate and Securities Group or any of the attorneys in our Shareholder Activism Subgroup listed below.

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