THE ROLE OF PRIVATE EQUITY AND ACTIVIST HEDGE FUNDS IN CORPORATE GOVERNANCE – RELATED POLICY ISSUES

Issued by the OECD Steering Group on Corporate Governance, January 2008

Following its earlier consideration of hedge funds and private equity, the Steering Group on Corporate Governance considered policy issues from the perspective of the Principles of Corporate Governance and agreed to release its findings.

Corporate Affairs Division, Directorate for Financial and Enterprise Affairs
Organisation for Economic Co-operation and Development
2 rue André-Pascal, Paris 75116, France
www.oecd.org/daf/corporate-affairs/

TABLE OF CONTENTS

THE ROLE OF PRIVATE EQUITY AND ACTIVIST HEDGE FUNDS IN CORPORATE GOVERNANACE – RELATED POLICY ISSUES

1. Summary, Main Conclusions and Next Steps

At its meeting in April 2007, the Steering Group concluded that private equity firms and activist hedge funds typically play a positive role in corporate governance when they have the right incentives to make active and informed use of their shareholder rights. The evidence gathered by several studies, which have been carefully examined and discussed by the Steering Group, shows that equity firms and activist hedge funds often act as informed owners and take a more active role in monitoring the performance of companies and their management than other institutional investors, contributing to a better risk and resource allocation in the economy as a whole.

To ensure that the legal and regulatory framework encourages active and informed shareholdings is therefore an important policy objective, which was also emphasised in the 2004 review of the OECD Principles.

The Steering Group also concluded that any corporate governance concerns that relate to governance practices by private equity firms and activist hedge funds are best addressed within the framework of the existing OECD Principles. But in order to remain relevant there may be scope for further clarification of how the OECD Principles can be applied with respect to governance practices commonly associated with private equity firms and activist hedge funds. It was underlined that, in order to have a better understanding of the issues and how to deal with them, this work should include a dialogue with the private sector.

Already during its preliminary discussion, the Steering Group identified a number of issues that are closely (but not uniquely) associated with "activist ownership" in different forms. This document builds on the Steering Group's discussion and provides a more in-depth analysis of areas where effective use of the OECD Principles and the Methodology would benefit from an exchange of experiences and examples of how to effectively implement the OECD Principles. The issues are divided into three main groups.

- Considering the ownership strategies of private equity firms and activist hedge funds it is no surprise that the broadest category of issues relate to the efficiency of the market for corporate control and influence, particularly with respect to ownership disclosure and conflicts of interest. In terms of ownership disclosure, questions arise about the optimum level, timing and content, particularly with regard to the extensive and "pro-active" use of financial innovations by equity firms and activist hedge funds. How much disclosure (and when) should be required, for example, with respect to share lending and various forms of derivatives with latent voting rights? A special case in terms of content and timing of disclosure is when shareholders consult or intend to act in cooperation. Concerning conflicts of interest an issue that keeps coming back is the role of the board, which plays a pivotal role as a counterpart with potential buyers. How should, for example, independent judgement by the board members be safeguarded when their personal incentives, such as remuneration and compensation plans, are involved in a takeover? Formally, the management of potential conflicts of interest are often covered by general provisions about the duties of the board. However, experience has shown that enforcement can be difficult, which has motivated some jurisdictions to specify more specific obligations and liabilities in takeover law and other more adapted regulations.

- A second group of public concerns relate to stakeholder issues, particularly the employment effects and the protection of company's creditors rights. It is important to note that empirical evidence doesn't lend support to concerns about either firm level or aggregate level negative effects on employment of the new forms of activism. The OECD Principles primarily focus on the need to recognise the rights of stakeholders established by law or through mutual agreement during this process of restructuring. Several of the private codes address these issues calling for private equity to clarify their plans with respect to a portfolio company and to inform all the groups involved.

- A third area of discussion has been about the possible need for additional reporting requirements by private (not publicly traded) companies. Behind this debate is the prospect that very large publicly traded companies, whose activities are considered of "public interest", may go private through a buy-out and no longer remain subject to the same reporting requirements. Regulating in favour of more extensive disclosure requirements for private companies could be one possibility but may not be the best avenue given that thresholds will be arbitrary in a market segment that is quite dynamic. For private equity portfolio companies another possibility is to use industry codes of best practice, perhaps on a comply or explain basis. This seems to be the approach taken by some countries and the industry itself. A recent example is the UK's Walker Committee Guidelines (see annex I).

Given the Steering Group's early discussions, the findings of this paper and available resources, it is suggested that the Steering Group should focus its work on the following set of issues that primarily relates to principle II.E on the market for corporate control, principle II.G covering consultation between shareholders, and the principles of Chapter IV that cover legal and contractual relations with stakeholders:

- Arrangements covering consultations between shareholders; notification of ownership/voting power, and the effective use of voting rights;

- Conflicts of interest and the role of the board during changes in corporate control;

- Consider how stakeholder rights that are established by law or through mutual agreements are respected.

The purpose of the work will be to examine how well the OECD Principles and the Methodology address and provide guidance to the concerns that have been raised in the wake of a more active market for corporate control and influence. Particular attention will be given to their relevance in relation to evolving corporate governance practices by private equity firms and activist hedge funds. In an active information exchange, the analysis will take into account existing voluntary standards that are established and promoted by the industry. The conclusions can be issued as an explanatory note to the OECD Principles and /or the Methodology.

2. The Structure of this Report

The first section briefly reviews the policy framework that serves as a benchmark for the discussion of more specific policy issues in the following sections. Section two considers key market integrity issues including insider trading and the management of conflicts of interest. The question of how to deal with takeovers involving insiders is also taken up in this section. Section three considers stakeholder issues including the treatment of creditors, challenges to the insolvency system and employees. Section four deals with several fundamental aspects of corporate law that underpin the corporate governance framework. They include the use of target company assets as collateral following a takeover and the issue of reporting requirements for formerly listed companies. Section five briefly reviews the developing issue of "short termism" that is sometimes associated with alternative investors but is in fact a broader issue. It also briefly discusses issues that might arise when private equity funds list on the public markets. Annex I reviews current industry codes and guidelines.

1. THE POLICY FRAMEWORK

It is worth recalling at the outset the fundamental policy goals/issues that can drive immediate concerns such as to improve or preserve good corporate governance. One general classification of policy goals is: to improve resource allocation and growth (Principle I.A states *inter alia*, that "the corporate governance framework should be developed with a view to its impact on overall economic performance"); promote capital market efficiency; and achieve equity goals. In some cases the policy goals may be complementary as when good corporate governance standards lead to better valuations and a lower cost of capital. The latter should underpin growth prospects. But there can also be policy trade-offs making regulatory impact analysis (including the identification of market and regulatory failures) indispensable in determining a policy balance. For example, improved resource allocation and growth prospects may require different policy judgements with respect to corporate governance systems (e.g. more aggressive takeover arrangements) with potentially negative impacts on some existing stakeholders.

The current corporate governance framework and debate reflects some of these issues. For example, an important policy concern in many OECD countries is to increase the pool of available risk capital and to focus it not only on new enterprises and activities but also on the restructuring of existing companies. Thus many jurisdictions are concerned to promote risk capital through the provision of numerous tax and other advantages (EVCA, 2006) and by the establishment of special listing requirements for high-tech companies and new start-ups. Examples include the drive by the EU to establish a European-wide capital market and a favourable cross border merger regime. Insolvency arrangement and personal bankruptcy law have also been examined from the perspective of improving economic dynamism (OECD, Growth Strategy).

Policy coherence can be a problem since policy in this area can involve fairly arbitrary thresholds with subsequent side-effects. Thus venture and growth capital funds are often the object of positive policy commentary as can be private equity buyouts of private companies and smaller listed companies. All these business activities might even be undertaken by the same private equity firm. However, other private equity buyouts, even of firms in difficulties, are treated in a more sceptical if not hostile manner, the approach being that they are inimical to growth until proven otherwise. The approach of the Walker Committee (see Annex 1) in the UK takes this approach focusing only on large transactions and arguing that the private equity buyout industry should sponsor research proving its macroeconomic benefits. The political economy setting is quite different as it is for bad debt buyout funds, insolvency work-out sponsors etc that are also often seen in a negative light. There is, however, a danger in setting a threshold for what is considered to be worthy and not worthy since a division may always lead to unexpected changes in behaviour around the threshold. Thus there may be a case for changes in the capital gains tax laws covering capital gains arising from buyouts, but establishing thresholds to, for instance, protect growth and venture capital funds is far from easy and may lead to changes in behaviour and restructuring of transactions in unanticipated ways.[1]

There can also be similar issues in defining arbitrary thresholds in other areas. Most jurisdictions would, for example, support a positive role for "informed" investors and advocate instruments for engagement such as voting rights for elections to the board, say-on-pay etc. At the same time, the appearance of activist hedge funds has provoked feelings of unease in some quarters together with demands for policy initiatives to curb their activities while somehow not discouraging more "acceptable" activists. Where is the borderline between two, especially when they do often work together and have overlapping interests, at least for a period? The issue of thresholds and different policy responses for what on the surface appear to be similar actions is taken up below.

2. PRESERVING MARKET INTEGRITY

The information gathering summarised in *The implications of alternative investment vehicles for corporate governance (*2007) identified several areas of potential concern regarding the behaviour of private equity and activist hedge funds. They are concerns about market abuse (especially insider trading), the management of conflicts of interest, the potential for undeclared joint action and whether change of control arrangements involving insiders are suitable in the context of new business models and market participants. They raise in turn question as to whether fiduciary duties of board members have been suitably defined and enforced.

2. 1 Market abuse

2.1.1 Insider trading

In the case of a buyout of a public company, there is a potential for market abuse amplified by the fact that many parties are involved in the transaction, not just employees of the buyout fund. The target company management is often involved at an early stage of planning and the complexity of financing

[1] Policy theory points to the need to have as many instruments as objectives. Thus if the public policy problem with private equity is the personal income of partners but there is also a desire to promote the provision of risk capital, two policy instruments would be required. It is also far from clear that changing the treatment of capital gains is the most efficient instrument when it comes to taxing private incomes as opposed to stimulating the provision of risk capital.

arrangements means that a number of investment banks and hedge funds, which might also trade in debt and derivatives, might also know of the intentions of the fund. The use of insider information to trade (market abuse) is of course a potential issue with normal M&A, but the number of people involved is usually smaller and they may not already be trading in the company's securities in different markets (e.g. credit default swaps) as will a hedge fund. The spread of confidential information appears to be more extensive than might often be assumed. One study reported that at one firm and for one deal there were around 200 insiders (FSA, 2007c). Some market participants think that the total number of insiders to a large LBO transaction might be as high as 1000 in some cases.

Although more persons are likely under present conditions to be insiders in private equity buyouts rather than in normal M&A, the appropriate policy response is unlikely to involve further legal changes. Rather, for entities under the supervision of a financial markets regulator, an administrative response might be most appropriate calling for entities to be more careful and better discriminate those with a need to know from those who do not. Codes of best practice might also be useful, especially for those entities not covered by the financial markets regulator. Unfortunately, it appears that in a number of markets (New York, London, Sydney) such information has been used in securities trading with unexplained price hikes in the days preceding an announcement of a LBO (FSA,2007a).[2] The Secretariat is unaware of any studies indicating that private equity LBOs are a particular problem.

Activist hedge funds are also in a position to potentially engage in market abuse but in a different way. For example, in one case other hedge funds (it could just as well have been other investors) became aware of an activist hedge fund's intentions before this information had been made public and traded on their insider information. Several regulators have expressed their concern, including the UK's Financial Markets Authority (FSA, 2007c). In a 2005 Discussion Paper, it expressed concerns that some hedge funds (not necessarily activist ones) were "pushing at the bounds of acceptable practice". The FSA also said that "it was suggested" that some larger hedge fund managers might be tempted to use their size to start market rumours, so as to deliberately move the market to benefit from advantageous prices. Activist hedge funds could, for instance, state that they would mount a campaign against a company only to sell its holdings when the prices rose. Only a few suspected cases were known to the Secretariat at the time of writing.

From the policy perspective, insider trading has long been seen as market abuse and a symptom of market failure and, compatible with the OECD Principles II.B, is banned in all OECD jurisdictions. However, it has also been one of the most difficult areas to prosecute and to enforce since proof is very difficult. This is even more so when insider trading is subject to criminal charges or involves a stricter criteria than for administrative sanctions. From a regulatory impact perspective, the task is not to stamp out all insider trading since scarce resources would be removed from other important regulatory issues. The task is to set priorities and to allocate scarce enforcement resources. The FSA classifies market abuse in private equity transactions as a risk of high significance, taking into account both impact (the potential harm that could be caused) and probability (how likely the event is to occur). This assessment was confirmed in their recent feedback report (FSA, 2007b). Soft regulation such as the use of industry codes and guidelines has an important but complementary role to play. Information programmes in some jurisdictions have also been useful in raising awareness of what actions might constitute market abuse. Industry codes might help widen the margin between unacceptable and acceptable conduct still further. Transactions monitoring systems are also being introduced in a number of jurisdictions to enhance monitoring capabilities across the market place and this should act as an additional deterrent.

2 FSA (2007a) suggests that a quarter of all deals leak in the UK. A New York Times study that is not based on the same methodology as the FSA found that 40% of deals are abused.

2.1.2 Acting in concert and notification of voting power and of intent

An issue that was highlighted in *The implications of alternative investment vehicles for corporate governance* (2007) is more germane for activist hedge funds and concerns the notification of stock ownership and of investor intentions. This has proved an issue in some jurisdictions where regulation is out of date and does not refer to instruments other than equity such as cash options. In a recent case in Switzerland, an investor (not a hedge fund) was able to build-up a position of 30 per cent in a company without technically exceeding the 5% threshold required for declaration. Another example concerns the Australian Takeovers Panel that ruled that derivatives had to be declared by an investor who had not done so, only to lose the case on appeal. There have been moves in some OECD countries (e.g. the Netherlands) to lower the thresholds for large firms where even a holding of well under 5 % (the EU Transparency Directive requirement, and above 5 % for SEC Schedule 13d in the US) might be considered a position of considerable strength.

Major shareholder notification requirements are changing in a number of countries in part so that publicly listed companies can identify who is controlling the way in which "voting rights" of that company are exercised. This is also an implication of OECD Principle V.A.1 that calls for the disclosure of major share ownership and voting rights. An example of recent regulatory changes include the UK where a notification obligation arises as a result of an acquisition or disposal of shares or financial instruments which results in the percentage of the voting rights which are held directly or indirectly (or through the direct or indirect holding of financial instruments creating such rights) reaching, exceeding of falling below 3% and any 1% threshold above 3% up to 100 %. Financial instruments entitle the holder to acquire issued shares to which voting rights are attached, (i.e. options, futures, swaps, forward rate agreements) and certain other derivative contracts. Concealed ownership is to a great extent handled by the definition of indirect holder of shares which occurs if a person is entitled to acquire, to dispose of or to exercise voting rights in respect of the relevant company, for example entering into an agreement with a third party who holds voting rights to exercise the voting rights in some concerted policy towards the management of the company or an agreement which provides for the temporary transfer of voting rights.

An issue that has arisen in some jurisdictions concerns share lending. From the view point of disclosure, borrowed shares are in fact bought shares so that they should be included in the global total to be declared if an investor is above a specified national threshold. They are not usually declared as a separate item since they are in fact legally owned by an investor, albeit temporarily. An issue that has caused concern is the possibility that shares might be borrowed with the sole intention of voting. The codes discussed in Annex I of this report take the position that shares should not be borrowed for the sole purpose of voting but do stress that this is the responsibility of the lenders. The Annex notes that in the UK one study found that only some 40 per cent of investors recall securities to vote so that the problem is more one of non-voting by investors than voting by borrowers. Of those share not recalled, it appears likely that only a small percentage were actually voted. The public perception is often that share borrowers have no economic interest in a company and therefore should not vote borrowed shares. However, this viewpoint is too restrictive. It appears that borrowed shares are used to top up an existing position so that the shareholder does have an economic stake in the company. The more controversial case concerns the possibility of "empty voting" whereby the investor has no economic interest in a specific company but is borrowing shares to vote regarding a transaction with another company in which they do have an interest. This is a quite specific issue but one that might occur only rarely in practice. The background to the codes detailed in Annex I suggest that an important issue is the lack of time between the release of a meeting agenda and the share blocking date, meaning that investors have little time to recall lent votes if they wish to vote. Finally it should be noted that from the perspective of the operation of financial markets, share lending serves to improve liquidity and the efficiency of price formation.

In some jurisdictions such as the US there is also a requirement for an entity reaching these notification stages to also declare their intentions with respect to the company. These provisions apply to all investors but also cover the case of active shareholders more generally including activist hedge funds. At least one country (Korea) introduced the requirement is response to an activist hedge fund and Germany is said to be considering introducing an equivalent to the US Schedule 13d. Takeover regulation might also include similar provisions but activist hedge funds are in general not interested in acquiring control of a company.

Of more policy significance in some jurisdictions is the approach to proxy solicitation and acting in concert covered by OECD Principle II.G (*Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse*).[3] The issues concern not just activist hedge funds but active investors more generally such as engagement funds. Research has shown that many activist investors do enlist the support of other investors in order to achieve their objectives (e.g. Becht et al 2006). This has been made possible by wide ranging changes in the rules in many countries (e.g. Canada and the US) and more liberal interpretations in others. In others there is a lack of clarity. However, there are some who would prefer a more restrictive stance transferring power back to incumbent managements and other shareholders (e.g. block shareholders).

In some jurisdictions (e.g. the Netherlands) an issue has arisen with joint action in the context of no or low quorum requirements. The issue is discussed further below (section on corporate law).

2.1.3 Conflicts of interest

As the FSA noted in its public feedback (FSA,2007b), "material conflicts of interest arise in private equity fund management between the responsibilities the fund manager has to itself, the investors in the separate funds/share classes it manages and the companies owned by the funds". Moreover, "advisors and leveraged finance providers also face significant conflicts (particularly when they take on multiple roles in relation to an individual transaction) between their proprietary and advisory activities and between their various clients". It ranked conflicts of interest alongside market abuse as a risk of high significance, a judgement that seems to be shared by a number of market participants.

Private equity funds do not always buy-up all the outstanding shares (apart from those it has allocated to management and the boards as incentives) opening the way for a potential conflict of interest with other shareholders.[4] This also raises the issue of related party transactions to the detriment of minority shareholders, a case which is said to have involved the company Celanese in Germany and the private equity firm Blackstone. As noted in Annex I, such transactions including management/advisory fees and sales of assets to related companies are also of interest to the fund's investors (limited partners) but appear to be covered to a great extent by agreements with limited partners. However, some market participants believe that not all transactions have been adequately covered by these agreements, particularly advisory

3 In the case of Deutsche Börse, the German prosecutors opened a case against a group of investors apparently on the basis that they had all used identical letters in communicating their views with the Board of Deutsche Börse. The case was dropped but a number of investors have noted uncertainties in being active investors in the German market.

4 See Cotter and Peck (2001) who find a sizeable number of buyouts where private equity firms did not buy all of the shares.

fees charge by entities related to the general partners and paid by the investee company directly to them. Several codes take up this issue that might also require other policy measures to prevent market failure.[5]

Management of the publicly listed target company might have a powerful incentive to pressure boards to sell the company too cheaply since they will benefit financially from the buyout. The evidence that this might have been a general occurrence is slim and cases in the past of controversial "quick flips" with high profits (usually a result of a private to private transaction as a division of a company has been sold) have been dealt with in part by "embarrassment clauses" where the selling company can recover a share of profits, and by greater resort to competitive auctions by the company being sold.[6]

There are number of laws and regulations that are intended to deal with conflicts of interest so that the question is whether they are working well in the new environment or whether they need further underpinning and adjustment. The most important instrument of company law and jurisprudence is the fiduciary duty of board members to all shareholders and the company. However, enforcement is particularly difficult in a number of jurisdictions and this might be particularly so after a LBO when the company has been taken private (see below, section on private companies). Another aspect concerns the protection of minority rights and in particular how related party transactions are handled. The issue in many jurisdictions is often one of lack of effective enforcement for minority shareholders.

Another approach is via industry standards of best practice and through codes. In this respect it is interesting to note that trade associations are already discussing the issue even though full adoption might be some way off. Thus the Dutch code and the EVCA guidelines both pay particular attention to dealing equitably with other parties and in dealing with conflicts of interest (see Annex I). The proposed UK code focuses more on disclosure issues but does call for disclosures about how both the board of the portfolio company and the general partners handle conflicts, including information about all payments by a portfolio company to the general partners.

Industry standards also appear to be evolving through private contracting between the general and the limited partners. Some observers (e.g. McCahery, 2007) believe that a level of contract standardisation has already been reached, underpinned by the long term relation between the general partners and the limited partners who may only number some 150, and often well short of this figure in individual funds. The need to continually establish new funds as others are wound-up gives a strong incentive to fund managers to manage potential conflicts of interest. This applies particularly to what could be termed related party transactions to the benefit of the general partners (e.g. management fees not accruing to limited partners).

2.1.4 Change of control transactions with the involvement of insiders

OECD Principle II.D states that "*markets in corporate control should be allowed to function in an efficient and transparent manner"*. Private equity LBOs can raise some important issues if implementation of the principle is to be guaranteed.

---

5 The question is also whether this is a case of market failure that is discussed more fully in *Towards better regulation in corporate governance: Experience in implementing Regulatory Impact Assessment (2007)*. Given the interests of limited partners in knowing about such transactions, any failure to incorporate them into contracts might suggest that they suffer from some lack of bargaining power.

6 In one of the few studies of LBO prices, Bargeron et al, 2007, argue that it is not that private acquirers pay so little but that public acquirers pay too much, suggesting severe corporate governance problems in the latter. The evidence can of course also be read as confirmation of sweetheart deals by insiders.

The implications of alternative investment vehicles for corporate governance (2007) noted that LBOs by private equity are almost invariably an agreed and not a hostile transaction since the partners usually have an interest in collaborating with existing management and sometimes also with some existing significant shareholders. The potential for conflicts of interest are thus apparent. By contrast, activist hedge funds have in general no interest in acquiring an enterprise, although in some instances they maintain the threat of a possible hostile takeover. The potential for conflicts of interest involving insiders during a change of control have often been handled by general laws covering the duties of the board and by laws and regulation covering market abuse and insider trading. However, the experience has often been that enforcement is difficult in normal circumstances leading some jurisdictions to more closely specify obligations and liability via takeover law and regulations that might be more flexible and appropriate in the current conditions.

A good example concerns Australia that has both strong fiduciary laws covering director's duties and also an active market in corporate control in an ownership environment characterised by dispersed ownership (e.g. greater effective powers for the existing board). They have very recently experienced a number of private equity takeover bids that have raised some questions about the adequacy of existing arrangements (Takeovers Panel, 2007). The Takeovers Panel has cast the potential problem more generally, defining the issue rather as insider participation in takeover transactions. Insiders who participate in a bid by having arrangements or understandings with the bidder and who have a financial incentive to ensure that the bid is successful are participating insiders. Such insiders may also have an interest in preventing potential rival bidders from making a bid for the target company and/or limiting the quality and amount of information provided to the potential rival bidders. This would be in order to deter other rival bidders and the market from being able to properly assess the value of the target company and achieve a lower price for the bid in which the participating insider is involved. This creates a conflict of interest that may have an effect on the efficient, competitive and informed market for the target's securities.

In addition, the Panel also noted that it would be concerned if professional and other advisors who, by reason of their previous association with a target company have come into possession of "non-public" information, seek to become part of an actual or potential bidding vehicle or bidding consortium, either in a professional capacity or as equity participants in the vehicle or consortium. These are real issues that might be particularly important in small markets. However, even in a case in the UK that was described in *The implications of alternative investment vehicles for corporate governance* (2007) (Allied Boots), it was difficult to find at short notice non-conflicted advisors required by their takeover code.

Solutions will need to fit the overall regulatory environment. In the case of the Takeovers Panel in Australia, a previous decision meant that there was no general requirement that a target company must provide equal information to rival bidders.[7] They have proposed that unless there are strong contrary arguments by the target company, a potential rival should have access to the same information, and in the same time frame as available to the bidder with participating insiders. As soon as a board becomes aware of a potential takeover bid in which there is a potential for some insider participation, it should establish appropriate processes and protocols to manage the issues which arise. In the US there is an important role for independent directors in the case of challenges to the courts (Delaware in particular) that can be

[7] The UK code seeks to ensure that bona fide potential rival bidders, if they request, have access to the same information as other bidders, regardless of the source of funding.

launched quite quickly. In both the UK and Australia, the takeover panels are active during the transaction so that issues such as access to information and information about acquirer's plans for the company and its financing can also be challenged in a timely fashion. Jurisdictions without such protection and processes might find private equity deals more challenging.

2.2 The boards role in protecting the interests of the company

The need for effective implementation and enforcement of the duty of board members to act in the best interests of the company and all its shareholders also arises in the case of activist hedge funds, especially in the case of demands for asset sales, distributions etc. The shareholders in a number of jurisdictions have a right to demand such actions, but board members also have to consider their duties, which is not to protect their own positions. How well this works in practice depends on many aspects of the specific corporate governance framework. However, the limited experience summarised in *The implications of alternative investment vehicles for corporate governance* (2007) shows that companies acceding to distribution requests don't appear to be materially weakened and those sold presumably move to a more effective management team (on average, allowing for the usual failure of business judgement).

However, in some cases it is reported that credit ratings might be reduced when companies accede to demands (Moodys, 2007) and the credit rating of existing debt of a company subject to a LBO also usually falls as the company's debt load increases. The credit rating that shareholders want to achieve (they usually are less risk averse since, unlike creditors, they benefit from upside risk) is not necessarily AAA so that a weakening does not say much about the effects of demands on the economic performance of the company. However, there is a stakeholder issue to consider. Acceding to demands of activist shareholders or accepting a LBO might be in the interests of shareholders but not in the interests of existing creditors. Company law and jurisprudence are, however, often quite vague as to how board members should balance these interests and Principle VI.C simply states that it "… *should take into account the interests of stakeholders*". However, creditors do have contractual solutions at hand, including the use of covenants to restrict the behaviour of the company and change of control clauses to protect their interests in the case of, *inter alia*, a LBO.[8] They also enjoy a number of rights in case of default depending on the insolvency regime (see below).

3. STAKEHOLDER ISSUES

Stakeholders figure large in the political economy of policy with respect to activist hedge funds and private equity. In addition to sometimes highly critical employees, existing managements and boards in some jurisdictions have strong views opposing alternative investors. Policy makers concerned with financial market stability have been concerned with leverage, especially on the part of banks and prime brokers with respect to hedge funds more generally. Risk-based policy has therefore focused on these two financial institutions (FSA 2007, ECB 2007) rather than the portfolio companies themselves and general partners, and has sometimes used private sector initiatives to monitor the situation and to advise market

8 In the months leading up to August 2007 there appeared to be a movement in both the US and in Europe to grant covenant-lite loans. However, covenant lite was not the same thing as no covenants.

participants (e.g. New York). In line with the Principles, this section focuses only on the corporate governance aspects of leverage in firms that are about to become private and on the potential insolvency issues. It also covers some of the intractable problems related to employee rights.

3.1 Leverage in corporate governance arrangements

Debt is used by the general partners of a private equity fund not just as a source of finance but also as a corporate governance tool. The management team of a portfolio company has a powerful incentive to succeed but is also under strong pressure from debt repayments and the associated covenants (covenant lite does not mean no covenants) to stay on track in the shorter term.[9] Simple comparisons with listed companies are therefore misleading and lower levels of debt and high cash balances might even be a sign of agency problems in listed companies.[10] However, the situation has been changing even before the financial turbulence in the third quarter of 2007. The precise composition of debt is evolving over time reflecting changing financial market conditions and financial innovation. A significant recent development in the structuring of larger transactions is the increasingly common use of non-amortising bullet debt, where no capital repayments will be made for a pre-agreed period, often around 8 years, after which a large payment falls due. Such debt has the benefit of allowing a company to use debt finance without having to eat into its short term cash flow to make large repayments. This development and others like it means that the level of debt is a potentially misleading indicator without knowledge about its structure. It is therefore important to note that the UK's proposed code of behaviour (Annex I) calls for a detailed disclosure of debt structure. This raises important issues about public disclosure by private companies (see below).[11]

3.2 Are insolvency laws still appropriate?

Principle IV.F states that "the corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights". The advent of new credit facilities associated in part with private equity buyouts may have changed the financial landscape for insolvency systems. In particular, the secondary markets for debt, and the packaging and widespread distribution of debt to more parties might have changed the dynamics of creditor negotiations in the event of a work-out. There is some preliminary evidence from the US that the advent of hedge funds (and other specialised debt funds) trading in debt might have undermined the concept of common interest in a workout ((Baird and Rasmussen, 2007). Moreover, the FSA has classed unclear ownership of debt arising from the repackaging by banks of LBO debt as a medium to high risk. The same risk of course applies more generally and is not just a LBO issue.

---

9 The use of debt as a corporate governance device is also one reason why up till 2006/2007 many LBOs were confined to non-cyclical companies with strong and stable cash flows. Such firms also arguably suffered from governance problems in the form of free cash flows leading management and employees to pursue their own interests to the detriment of shareholders.

10 A lower level of debt in listed companies and high cash balance can be taken as a sign of risk aversion by management. This proposition is also supported by their preference for share buybacks rather than higher dividends which would be associated with a longer term commitment to shareholders. On the other hand, the fact that shareholders are selling firms to private equity while at the same time financing them as limited partners might indicate that investors have less risk aversion then managers thereby indicating an agency problem with listed companies.

11 Disclosure by portfolio companies of their repayment commitments certainly already takes place on a confidential basis with potential bond holders and credit rating agencies.

The policy issue is whether in the event of trading problems and insolvency by a portfolio company the general partners can simply walk away protected by limited liability. This is an issue so fundamental to the principle of limited liability that it probably does not make sense to question it on account of what is still a small percentage (by value or number of firms). Some moral commitment of partners combined with reputational damage if a private equity firm walks away from a company might be the most appropriate and flexible path. This is also because some companies with a high probability of insolvency are regularly purchased by private equity firms for break-up and policy is not served by curtailing this socially useful activity. The proposed UK code (Annex I) is taking this approach by requiring a commitment by general partners that they would see it as their responsibility to assist in the transition to management by a creditor group as smoothly as possible along the lines provided for in the statement of Principles of INSOL (International Federation of Insolvency Professionals) on multi-creditor workouts (INSOL, 2000). This is despite the fact that the duty of directors under the new Companies Act 2006 (Section 172) includes a requirement for directors, in certain circumstances, to consider or act in the interest of creditors of the company.

Another potential issue concerns distributions by portfolio companies financed by an increase in debt (e.g. leveraged recapitalisation with an extraordinary dividend). Such recapitalisations reached a peak in the first half of 2007 in response to cheap and ample credit with 29 cases mainly in the UK, Spain and France, but have certainly since fallen.[12] Portfolio companies that have shown that they can service debt and lower their debt/ EBITDA have been going back to the credit market often bringing debt once more up to its old level and using the funds to declare a special dividend. All of this is perfectly legal depending on company law regarding capital requirements and insolvency regimes so that a new policy issue is not readily apparent. Some have seen the practice, which is not that widespread and might have been more cyclical, as a dangerous sign of “short termism” in that private equity investors are removing resources from the firm. However, this judgement does suppose that all firms need resources and that they can be used productively. From a macroeconomic point of view, resource reallocation might be required and one of the market intermediaries in this process is private equity. For companies more generally, it would be through dividends and share repurchases, all quite legal and acceptable.

The obvious problem with leveraged recapitalisation is when the transactions are not done in good faith and weaken the company – and also when there has been a genuine business misjudgement. Most insolvency systems allow for the unwinding of undervalue transactions made by companies in financial difficulty but this may not be appropriate in the case of special dividends unless they placed the company in an untenable position at which point the duties of directors become a key issues.[13] As the issue is fundamental to basic notions of the company, it is discussed again in the section on financial assistance.

3.3 Issues related to employees including pension funds

Principle IV.A recommends that “*rights of stakeholders that are established by law or through mutual agreements are to be respected*”. A particularly controversial area concerns the rights of employees in a LBO, although many of the issues are common to normal M&A transactions as well. Labour market law continues to hold regardless of a change in ownership as do legal requirements for consultation or participation such as via works councils. The more controversial cases concern mutual agreements and

[12] Data taken from Financial Times, July 25, 2007, Corporate Finance Special Section

[13] One expert proposes that company boards should publish a statement or assurance of solvency in advance of distributions in terms of reasonable expectation on the current evidence that the company is and will remain a going concern. (Rickford, 2006)

established general work conditions. In some jurisdictions, the continuity of employment terms and conditions are guaranteed, although only where there is an effective transfer of the company from one identified employer to another, something that normally does not apply to a LBO.[14] Change of control clauses are apparently also used in mutual agreements in some jurisdictions. However, many of these mutual agreements are subject to periodic renegotiations. While renegotiation takes place to incorporate changes in the general economic and business conditions, the case of an LBO is somewhat different. In this case, the company (i.e. its board by agreeing to a takeover (new shareholders) and its shareholders in selling) has decided to change its economic structure by taking on more leverage as well as by adopting new strategies etc thereby leading to a changed negotiating environment. Lower cash balances, tighter adhesion to a business plan etc will place pressure on existing implicit and explicit agreements, although many of the same considerations will also apply to an ordinary M&A transaction and indeed to companies that have decided on a radical reorganisation to remain competitive.

Policy conclusions in this area are not self-evident and are possibly highly country specific. However, a more generally policy issue might be the provision of information, if not during the negotiation for a LBO, then certainly after the company has been taken private. This issue is discussed more generally below. In a number of jurisdictions private companies beyond a certain size are required to disclose regularly information to stakeholders in general to enable them to negotiate on a common basis.

In some jurisdictions such as the UK, pension funds operate on a company basis but the regulator has powers to ensure funding for a scheme, something that becomes important in the case of a change in control. In particular, they have to ensure that the company's contribution to the fund's capitalisation is adequate. Clearly if circumstances change such as in a M&A or a LBO, there might be a legitimate demand for a greater capital investment by the company. Indeed, in a recent case in the UK (Allied Boots) an important part of the negotiations with the private equity firm involving the pensions regulator was the need to increase the company's contribution to the pension fund.

---

14 This is the case with the EU Acquired Rights Directive which also specifies that dismissals directly linked to the transfer of ownership shall be considered as unfair labour practices. There is also a private remedy in some cases. In the US, some collective agreements also have "successorship clauses" that guarantee the continuity of the collective agreement after a take-over.

4. FUNDAMENTAL ISSUES FOR COMPANY AND SECURITIES LAWS

Activist hedge funds and private equity firms have led critics to ask fundamental questions about corporate law. In several countries, activist hedge funds have led to great hostility and to the use by companies of defensive measures including poison pills. Questions have also risen about whether shareholders should even have rights such as demanding resignations or to receive greater dividends. In response to an exaggerated threat of takeovers including private equity deals, defensive mechanisms have been introduced and companies have established extensive cross shareholdings in some jurisdictions. These issues go beyond the remit of this paper. This section is therefore concerned with several more basic aspects of company law and reporting obligations.

4.1 Special laws for private companies but also for LBOs?

Many OECD jurisdictions have chosen to have a basic company law with special provisions for private companies and for public/listed companies. One objective concerns market efficiency: policy has sought to make it easy for new firms to incorporate in order to promote new start-ups and therefore entrepreneurship. Bankruptcy law has also been eased in many jurisdictions to ease exit by unsuccessful enterprises and a number have also made it easier for a failed entrepreneur to return to business activities. Generally speaking, there is strong cross section empirical support for the proposition that ease of entry and exit does lead to increased start-ups, a larger number of firms growing to public company status and, *ceteris paribus*, higher economic growth.[15]

However, the growth of private equity backed LBOs (and other LBOs for that matter) has raised issues about this model since they invariably use the legal form of a private company. One of the reasons for doing this is that company law in many jurisdictions prohibits a company from giving financial assistance to purchasers of its shares in order to both protect creditors as well as non-controlling shareholders. However, this prohibition does not in general extend to private companies, although there are often side conditions that must be met such as shareholder approval and the establishment of balance sheet reserves to ensure capital maintenance.[16] The EU's Second Directive, Article 23, which must be transposed into domestic legislation by member states, also excludes private companies (Ferran, 2007). The transaction is straight forward: an acquiring private equity fund may not be able to immediately pledge the assets of the investee company to back its borrowing as this would constitute financial assistance.

15 It is important to note that this finding is subject to other things being equal: the OECD Growth Project also included in its growth equations the catch-up effect (convergence on higher productivity leaders), human capital and demographics etc. The finding is thus quite robust in a cross section econometric context.

16. Germany has a more relaxed regime for private companies and Italy now also provides a safe harbour from the law on financial assistance for LBOs that are structured as mergers. The Netherlands has recently moved to provide exemption for financial assistance by private companies. Spain does not have a more relaxed regime for private companies.

However, once the company is acquired and taken private it can pledge the assets although subject to varying restrictions. The law in some countries is more restrictive than in others and opacity and certainty also varies leading industry associations to argue that transactions costs are often increased (EVCA, 2004).

To provide an example, in the UK private companies were within the scope of the domestic ban on financial assistance until 1981 when implementation of the EU Second Directive was taken to relax the ban so as to permit private companies to give financial assistance on certain conditions that were designed to ensure the maintenance of capital and to give shareholders a say in the decision making process. This relaxation has been identified as a key factor affecting the growth of management buyouts in the UK during the 1980s. The new Companies Act that will be implemented during 2007 has abolished entirely the law on financial assistance as applied to private companies. Private companies, however, remain subject to maintenance of capital requirements and thus care will be needed that financial assistance is not an illegal disguised distribution. The UK approach is that agency issues (i.e. corporate governance) are instead properly handled by the general company law on directors' duties (they must provide a solvency statement and general powers make them liable to consider creditors interests), minority protection, takeover regulations and insolvency laws (i.e. the corporate governance framework).

Functional equivalence applies in this area as in others. Thus France, where there is also an active LBO market, takes a cautious interpretation of financial assistance but the payment of post-acquisition dividends is a key mechanism whereby the target company assets can be made available for use in the repayment of the acquisition finance (EVCA, 2004).

4.2 Are the reporting requirements for non-listed companies adequate?

A key corporate governance policy issue concerns reporting obligations of private companies that are usually much less onerous than for publicly-held companies. Reporting regimes for private companies are usually based on certain thresholds for employment, assets or turnover, with audit requirements also based on thresholds. Exceptions are, however, often granted to fully owned subsidiaries if there is an unlimited guarantee by the parent company. The rationale for these requirements is that information about the companies is important for commercial transactions such as borrowing (including establishing a credit rating) and for the operation of labour markets where collective bargaining must be based on a sound understanding of the financial and competitive condition of a company. Reporting to limited partners of a private equity fund is governed by contractual arrangements since the investors are regarded as sophisticated. It is widely thought to be effective and not in need of additional regulatory intervention in both the US and in the UK. As noted above, however, some elements (e.g. advisory fees not paid to the fund) might require strengthening but this might best be handled on a private basis.

In many jurisdictions, the situation has changed thereby requiring a reassessment as to whether the approach is still appropriate. First, the advent of large LBOs means that there might be a number of very large companies (i.e. "public interest") that were not foreseen in the original company law or disclosure regulations. Second, director's duties may have been widened to such an extent that they outstrip disclosure requirements that indicate to the other members of the company that the duties are being carried out effectively. Third, the provision of finance has changed in favour of secondary credit markets with the insider role of banks (and especially a lead bank with insider knowledge) now less important.

A number of large private companies, including those owned by private equity funds, have adjusted their public reporting to take account of the new situation, including with respect to reporting to credit rating agencies, albeit perhaps on a confidential basis. However, it appears that other companies have only adopted superficial additional reporting to the public. With investors already in receipt of detailed information, the authorities need to ask whether there is a case for additional reporting but less extensive than for publicly-held companies. Regulation is one possibility but might not be the best given the clear need to establish thresholds which are quite arbitrary and in a market segment that is quite dynamic. For private equity portfolio companies one possibility is to use industry codes of best practice, perhaps on a comply or explain basis. This is the general approach taken by the EVCA and Dutch codes and recommended by the UK by the Walker Committee (see Annex I) that calls for disclosure very similar to that required of listed companies. One additional argument is that such large companies already have extensive internal reporting lines and direct reporting to general partners so that additional reporting costs might be negligible if at all.

The question that needs to be decided is disclosure about what. Apart from normal financial accounts, though perhaps less detailed than for public companies, two issues stand out for portfolio companies. The first concerns leverage that is usually high and complex. In particular, a significant proportion of debt is so called “bullet debt” where no interest payments are made till the loan matures say in eight years. Thus little information will be conveyed by looking only at free cash flow. For the immediate primary issuers of such debt who can impose covenants there is recourse if the firm has misrepresented its overall debt situation in confidential talks with the lenders. However, for other creditors such as suppliers and for the secondary markets such information might not be fully available. The second area concerns the composition of the board of the portfolio company. Even though the company is controlled, the board members nevertheless still have their duties to fulfil that are specified in company law. Their names might be available as part of the normal submission by private companies, but what may be needed is additional information about their status.

Some parties have argued that executive and board member remuneration should also be disclosed but the corporate governance grounds for this do not appear to be very strong. In the case of listed companies, shareholders need to know about the structure and magnitude of incentives in order to judge whether the agency problem has been solved through an alignment of incentives. Private equity is based on a different model with strong incentives for both the general partners and management, which should be known to investors (limited partners). Similarly, demands to know the identity of limited partners also goes too far. Limited partners are neither shareholders in the portfolio companies nor do they have a management role in the private equity fund in return for which they enjoy limited liability.

4.3 Quorums for key decisions

In several jurisdictions, activist investors including activist hedge funds have served to raise the issue of quorums for decision making. For example, a small group of activist investors might be able to dominate an annual general meeting where there is low shareholder turnout and where the required quorum for decisions is quite low.[17] In some cases, a company has set the required quorum low in order to ensure successful general meetings of shareholders (said to be the case in Japan). Quorums might be set in company law but can be changed by individual companies in their articles. The general policy issue is not the presence of activist investors but the reason for low shareholder participation. Low participation swamps the supposed effects of share borrowing (Annex I). In some countries there has been a steady increase in voter turnout in recent years but the role of policy remains unclear at the time of writing.

[17] In one case in the Netherlands, two hedge funds that owned 32% of a company carried a vote by 86.5% of shareholders at a poorly attended meeting.

4.4 The corporate governance issues of listed private equity entities

An issue that is now confronting listing authorities in several countries (e.g. the Netherlands, UK) concerns the listing of private equity funds or private equity companies and hedge funds.[18] Several funds of private equity companies have been listed on stock exchanges such as a KKR fund listed on the Euronext in Amsterdam. However, listed private equity funds do not appear suitable for the traditional private equity model that relies on capital commitments and sometimes a long period before an appropriate investment is found. In the case of investors in the KKR listed fund, they expected and their returns depended on immediate investments. Investors also apparently did not like commissions being paid immediately to the private equity company.

More interesting from the policy perspective is the case when a private equity company seeks a listing by selling its shares in an IPO.[19] The issue is normally put in terms of comparisons with holding companies that are usually subject to corporate governance and reporting requirements like any other publicly-held company. There is an argument that with control over trading companies they should be subject to the usual corporate governance and transparency requirements as any other company/conglomerate. It is important to note that such requirements do not include detailed reporting about subsidiaries (only line reporting) that is often the demand of critics. One approach is being taken by the FSA (2007d) that is treating listed private equity companies as a generic issue of listed investment closed-ended funds, adapted to accommodate modern investment techniques such as private equity and hedge funds. Transparency requirements will be introduced with quarterly reporting of the major investment positions and a statement of investment policy. Importantly, there is a requirement for board independence: an independent chairman together with a majority of independent directors will suffice to meet the board independence criteria. Critics still complain about the lack of detail about portfolio companies, important since each has its own debt and operational structure. More importantly, and in contrast with listed conglomerates, there is no unlimited guarantee between the private equity company and the portfolio company.

An argument against the listing of private equity funds is that the business model incentive structure will be distorted. The close link between the compensation of the general partners and the success of portfolio companies might be weakened as a greater share of their income might come from shares and share options.[20] There could also be a conflict of interest between shareholders and the limited partners with the latter focused on the portfolio company/companies and the former on more general share price development of the general partner firm. However, these issue are for private investors to decide and do not appear to be appropriate for policy intervention.

---

[18] Tax issues are also involved, for example in the case of Blackstone on the NYSE. This section is only concerned with corporate governance issues.

[19] Although Blackstone's listing on the NYSE took a lot of attention, there are already a number of listed companies with significant private equity transactions. They include 3i which derives 40% of its profits from buyouts, Goldman Sachs and Lehman Brothers.

[20] Industry-wide partner returns from carried interest, determined by the sale price of the portfolio company, outnumber those from management fees by a ratio of 4to 3. This estimate is probably an underestimate with a number for firms still to be sold after a recent surge in activity but is indicative of ex-ante incentives. See Cheffins and Armour, 2007

5. THE NOTION OF "SHORT TERMISM"

Policy issues related to private equity and activist hedge funds are frequently associated with the idea of "short termism" which is often asserted to be the root problem of modern capital markets (e.g. Tonello, 2006 and Marathon Club, 2007). As discussed in *The implications of alternative investment vehicles for corporate governance* (2007) the holding period of securities by both activist hedge funds and private equity cannot be taken as evidence of "short termism" since it says little about the time perspective behind the valuation of a company. Due diligence by private equity is extensive and they can hardly be criticised for not looking at growth prospects of a company. Activist demands such as selling the company cannot easily be pigeonholed as "short termism" since perhaps what is required is a whole new management team to improve the performance of a company. Moreover, the activist shareholders often remain as shareholders after such a transaction. It was also noted that company advisors recommend that the best way to counter activist hedge funds is to have an informed board and a clear corporate strategy for using cash reserves and unused leverage possibilities. Even major critics such as the Conference Board (Tonello, 2006) note that markets do seem to value intangible assets and expectations of future growth. Complaints by managements of "short termism", very often meaning quarterly reporting, might also be misleading. Research shows that the key issue is not quarterly reporting per se but quarterly earnings guidance combined with maturing options. Guidance has also been correlated with extensive balance sheet provisioning to manipulate earnings guidance indicators such as earnings per share, and with accounting restatements. The number of companies issuing earnings guidance has declined markedly in the aftermath of Enron and other scandals.

There is also an extensive literature regarding reporting by companies of their strategic plans and evidence that capital markets do value such information as well as R&D expenditures and other investments as long as such activities do offer the prospect of reasonable future returns and can be viewed as part of a company's strategy (OECD, 2006). There remain policy issues in this area to improve capital markets, but they are more general and while perhaps stimulated by alternative investors it is not really a policy issue vis-à-vis alternative investors. In short, while capital markets might not have perfect foresight they are very far from being myopic.

Nevertheless, "short termism" remains on the popular agenda if not for the time being on the policy one. "Short termism" can be defined as the rate of time preference (i.e. should a company/society chose to grow pines or oak?). As such there are very many determinants both macroeconomic and micro economic if not also psychological. The aging of many OECD populations should be expected to have increased the rate of time preference and to have led to reduced time periods for investment planning. Greater technological obsolescence would also lead to the same effect, firms speeding up their technological cycles and investment (including R&D and product innovation) leading to the misleading appearance of "short termism". Microeconomic factors are also important such as tax systems, incentive structures for fund managers and some corporate governance arrangements such as setting executive remuneration. In sum, while short termism might well be a policy issue worth investigation, it is by no means clear that shareholder activism and private equity should be regarded as a symptom of market failure but rather a reaction to it.

BIBLIOGRAPHY

Baird,D. (2006), "Legal approached to restricting distributions to shareholders: the role of fraudulent transfer law", *European Business Organization Law Review*, 199

Baird, D. and R. Rasmussen (2007), *Common Pools, Common Disasters, and the Anti-commons: Hedge Funds in Modern Reorganization Law*, Paper presented to Activist Investors, Hedge Funds and Corporate Governance, Amsterdam [check for quotation]

Bargeron,L. et al (2007), "Why do private acquirers pay so little compared to public acquirers", *Fisher College of Business Working Paper Series*, WP 2007-8, Also SSRN, abstract 980066

Becht, M. et al (2006), "Returns to Shareholder Activism: Evidence from a clinical study of the Hermes UK Focus Fund", *ECGI Finance Working Paper*, 138, Brussels

Cheffins, B. and J. Armour (2007), "The Eclipse of Private Equity", *ECGI Law Working Paper*, 82/2007

European Commission, 2005, *Green Paper on the Enhancement of the EU Framework for Investment Funds*, COM 314

European Commission, 2006, *Report of Alternative Investment Group: Developing Private Equity*

European Venture Capital Association (EVCA), (2004), *Debt Financing Structures*, Brussels

European Venture Capital Association (EVCA) (2006), *Benchmarking European Tax and Legal Environments*, Brussels

Cotter,J. and S. Peck (2001), "The structure of debt and active equity investors: The case of the buyout specialist", *Journal of Financial Economics*, 101

Ferran, Eilis, 2007, "Regulation of Private Equity-backed Leveraged Buyout Activity in Europe", *ECGI Law Working Paper*, 84

Financial Services Authority (2005), "Hedge funds. A Discussion of Risk and Regulatory Engagement", *Discussion Paper* 05/04, London

Financial Services Authority (2006), "Private Equity: A discussion of risk and Regulatory engagement", *Discussion Paper* 06/06, London

Financial Services Authority (2007a), “Update measurement of market cleanliness”, *Occasional Papers Series*, 25, London

Financial Services Authority (2007b), “Private Equity: a discussion of risk and regulatory engagement”, *Feedback statement*, 07/3

Financial Services Authority 2007c, “Thematic review of controls over inside information relating to public takeovers”, *Market Watch*, 21, London

Financial Services Authority 2007d, “Shareholder activism”, *Market Watch*, 20, London

Financial Services Authority 2007e, Investment entities listing review”, *Consultation Paper,* 07/12, London

International Association of Insolvency Professionals (INSOL), 2000, *Statement of Principles for a Global Approach to Multi-creditor Workouts*

Marathon Club, (2007), *Guidance Note for Long-term Investing*

Moodys (2007), *Short-term shareholder activists degrade creditworthiness of rated companies*, New York

OECD (2006), *Intellectual Assets and Value Creation: Implications for Corporate Reporting*, Paris

Rickford,J. (2006), “Legal approaches to restricting distributions to shareholders: balance sheet tests and solvency tests”, *European Business Organization Law Review*, 7, 135-179

Takeovers Panel (2007), *Issues Paper: Insider participation in Control Transactions*, Australia

Tonello, M. (2006), “Revisiting stock market short-termism”, *The Conference Board Research Report*