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Case Study: Take-Two Interactive Software, Inc.

Besides a remarkable example of shareholder resolve, Take-Two Interactive illustrates neatly how an exempt proxy solicitation works.

A noted media turnaround executive got four investors got together in 2007 to take control of a failing portfolio company. It required diligent research, careful communication, and a thorough understanding of SEC regulations and company bylaws.

They took advantage of the "ten-or-fewer investors" exemption in proxy solicitation rules, and achieved what many other investors, activist and otherwise, frequently fail to get: control of the BoD and a change in the executive suite. Better yet, they did this at low cost and with little trouble relative to other similar efforts.

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"Can't we just call these four or five people up and change control?"

The cast of characters

Take-Two Interactive, pioneering video game producer of Grand Theft Auto, one of the most successful early video games, famous for its sex and violence.

Strauss Zelnick, proprietor of ZelnickMedia, high-end media investor, consultant, and turnaround artist. Former CEO of BMG Entertainment, a major record label.

And, the investors:

Oppenheimer Funds	25%
D.E. Shaw (David Shaw)	9%
SAC Capital (Steven Cohen)	8%
Tudor Funds (Paul Tudor Jones)	5%

A company in distress

Take-Two had fallen on hard times, between competition from Electronic Arts and some of its own internal missteps. The latter included deep involvement in options backdating, which swept up its founding CEO, four accounting restatements in five years, and threatened delisting due to failure to file financial reports with the SEC and to hold an annual shareholder meeting.

By late 2006, investors had become frustrated and restless. With reliance on a fading game franchise, a highly volatile share price, and the aforementioned governance problems, they were ready for a change.

Strauss Zelnick gladly obliged. In late 2006 and into early 2007, he approached major investors "one by one" to make the case for that change. He'd begin with the BoD, then move on to the top executives. How did he do this, without the company finding out through SEC filings?

Homework pays off

Zelnick did some clever homework, not only on the business and its executives, but also on its governance and investors.

- The company lacked a shareholder rights agreement, which meant that investors could freely collaborate on a turnaround plan, including BoD restructuring and replacing top executives, without risking dilution to their investment.
- The company also lacked any advance notice provisions for nominations to the BoD. In this way, investors could propose directors at any time, rather than the usual 120 days before an annual meeting
- The bylaws allowed investors to act by written consent, meaning that if enough of them approved a given set of actions (say, dismissing incumbent

directors) in writing, then they did not need a formal shareholder meeting to approve those actions.

- Any director election would require a director win only a plurality of votes cast. An investor candidate would need enough votes to exceed those that incumbents might win, and no more.

Zelnick also researched the investor base carefully. Three investors (D.E. Shaw, SAC Capital, and Tudor Funds) were hedge funds that had the flexibility and appetite to fight for changes at the company, although as will become clear, they hardly needed to fight. Together they represented 22% of the shares, enough to matter but not enough to assure they would have the shares to prevail in any sort of vote.

The fourth investor, Oppenheimer Funds, came from a more traditional mutual fund background. They had not had any sort of activist role at their portfolio companies; to our knowledge they had not filed a Form 13D on any of their companies up until Zelnick approached them, and have not done so since. Yet, they owned a substantial stake in a prominent media company, and must have become unhappy with the performance. When three big-time hedge funds jumped in, it probably took little internal debate to decide to follow. Once they did, Zelnick had the votes to win just about anything he might propose there.

The non-drama unfolds

There's actually very little public documentation to explain what, exactly, transpired at Take-Two, at least until March 7, 2007, when the investor group disclosed their intentions. At that point, Take Two had held is previous annual meeting on June 16, 2005, almost two years before.

We can infer that in late 2006 and early 2007, Zelnick persuaded these investors that the BoD and executives needed to go. Next, the investor group started to prepare a series of written consent actions. This would allow the group to act in lieu of a shareholder meeting, since none appeared forthcoming. The consents provided for removal of incumbent directors, addition of investor nominees, expansion of the BoD, and other technical steps needed to restructure the BoD.

Probably because of the threatened delisting, Take-Two scheduled an annual shareholder meeting. They filed a routine proxy statement on February 28 announcing the shareholder meeting for March 23, a little over three weeks later. The company nominated six incumbent directors.

Both the announcement and the timing of the meeting played right into investors' hands. The annual meeting allowed them to dispense with the complicated written consent process. The timing meant that Take-Two had very little time to react and respond to a determined group of investors intent on changing things around.

Things moved quickly after that. On March 7, the investors filed their initial Form 13D, disclosing that on March 3 they had formed a "group" under SEC regulations.

Their 47% shareholding exceeded the 5% threshold for reporting activist intent, so they clearly had to file. That filing, a mere sixteen days before the annual meeting, spelled out the short-term future for the company:

- Investors will support six of their own director nominees, including Strauss Zelnick and another partner from ZelnickMedia, along with four other highly qualified media luminaries.
- The BoD will retain ZelnickMedia as a turnaround consultant, and then delegate authority to ZelnickMedia to fire the CEO and CFO.

A week later, on March 16, the investor group filed its series of written consents with the company. They likely did this, though, as a means of assuring that the annual meeting would proceed without incident. At that point it had become clear that the investors could just show up at the annual meeting, nominate their candidates, and count the votes.

Take-Two had few options left. They postponed the annual meeting from March 23 to March 29, to allow the BoD to "review the proposed actions of the shareholder group and also to evaluate alternative courses of actions…including a possible sale of the company." But, with the written consents filed, they could not avoid the reality that investors would replace the BoD either way.

And so it was. The annual meeting proceeded as scheduled on March 29. All four shareholders appeared in person and nominated five of their candidates, adding one incumbent director to their slate. They of course elected all six. At a BoD meeting that day, they appointed one other incumbent to the BoD. (Apparently two incumbent directors made the case that they deserved to remain on the BoD.) They also hired ZelnickMedia to the promised consulting contract, and fired the CEO.

Exempt Proxy Solicitation Made it Possible

We don't know what, exactly, Strauss Zelnick and the four investors, and possibly other investors, discussed in the weeks leading up to formation of a group. We do know that these discussions took place quietly, out of sight of the company, because Zelnick solicited only a small number of shareholders.

The "ten-or-fewer" exemption meant that he avoided preparing and filing proxy materials with the SEC. That filing would have revealed to the company, and to the public, the substance of the discussions that led the investors to form a group and take action. Had the BoD known in December 2006 of these discussions, rather than three weeks before the annual meeting, they could have communicated with investors themselves, restructured the BoD or changed executives on their own terms, or somehow taken more control of the situation.

Needless to say, investors also restructured the BoD at a relatively low cost. They avoided the expense of a proxy solicitor and public relations effort. Outside of the

need to prepare the written consents, they spent a fraction of what they would have otherwise incurred on legal fees. While David Shaw, Steve Cohen, and Paul Tudor Jones could have likely afforded to spend more, they just didn't need to.

They necessary legal fees that they did spend involved their forming a group and their Form 13D filings. They might have avoided even those costs, too. They filed Form 13D because they formed a group whose holdings exceeded 5% of the shares outstanding. Had Strauss Zelnick owned even a single share (according to SEC filings he did not), but under 5%, he could have solicited the proxies from the other four investors without even needing to file Form 13D disclosing his actions. He and the four other investors could have shown up at the annual meeting unannounced, nominated their candidates, and cast their votes.

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