

# M&A Commentary

June 2008

## CSX: Opportunities and Implications for Companies and Activist Investors

### Highlights

- District Court found that TCI violated Rule 13d-3(b), an anti-evasion rule promulgated under the Securities Exchange Act of 1934. District Court held that TCI acquired Total Return Swaps with the goal of preventing the vesting of beneficial ownership in the underlying common stock and evading the reporting requirements of the Williams Act.
- District Court's findings also validate long-standing concerns regarding coordinated "wolf-pack" activities of insurgent hedge funds. District Court held that TCI and 3G had formed a "group" for purposes of the Williams Act despite not having a formal agreement, and that the two hedge funds should have filed a Schedule 13D as a group months earlier than they did. District Court based its decision on what it viewed as overwhelming circumstantial evidence that the hedge funds had been working in concert.
- Despite finding these violations of the Williams Act, District Court determined that existing precedent prevented it from enjoining TCI and 3G from voting their shares at CSX' upcoming annual meeting. This absence of viable Williams Act remedies was confirmed by Second Circuit's refusal to enter an injunction pending appeal. Reflects continued need for SEC reconsideration of Section 13(d) rules and remedies.
- District Court's characterization of TCI and 3G interaction as "group" action may constrain hedge fund activities in future destabilization campaigns.
- Companies should reconsider utilization of "poison pills" and other traditional takeover defenses during destabilization campaigns in light of District Court's findings on beneficial ownership.

### Introduction

In *CSX Corporation v. The Children's Investment Fund Management (UK) LLP, et al.*,<sup>1</sup> the United States District Court for the Southern District of New York considered two important issues. First, the District Court addressed whether and under what circumstances a long position under a common form of equity derivative, a Total Return Swap ("TRS"), may be deemed "beneficial ownership" of the underlying stock requiring disclosure under the Williams Act.<sup>2</sup> Second, the District Court considered whether and at what point investors' activities would cause them to be deemed a "group" for Williams Act purposes. The Court found that the two activist hedge funds violated the Williams Act disclosure requirements in the context of both the holding of TRS positions and certain coordinated activities. However, the District Court determined that existing precedent prevented it from enjoining the two hedge funds from voting their shares at the upcoming annual meeting of CSX Corporation ("CSX"). The United States Court of Appeals for the Second Circuit subsequently denied CSX' request for an injunction pending appeal, placing the hedge funds' shares in escrow at CSX' upcoming annual meeting. Although the Second Circuit agreed to hear CSX' appeal of the District Court's denial of its requested relief on an expedited basis, this process will not commence until after the annual meeting.

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Set against the backdrop of two activist hedge funds running a destabilization campaign, this decision contains important lessons for both activist hedge funds and public companies in the current environment of widespread activist hedge fund destabilization campaigns. In this *M&A Commentary*, we explore the ramifications of the decision and set forth some suggestions for how companies might confront the issues of derivative share positions and coordinated investor “wolf pack” actions in a corporate control context.

### **Factual Background**

In CSX, two hedge funds, The Children’s Investment Fund (“TCI”) and 3G Capital Partners (“3G”), were running a proxy contest to capture five of the twelve board seats at CSX, a major railroad company, in order to facilitate their campaign to force CSX to revise its business strategies in accordance with the hedge funds’ agenda. Beginning in October 2006, TCI had expressed interest in CSX in a number of ways, including meeting with CSX’ financial advisors, exploring the possibility of a leveraged buyout and contacting other hedge funds about CSX. TCI, joined by 3G, eventually began preparing for a potential proxy fight and simultaneously began to vet potential directors.

During this period, TCI also increased its economic position with respect to CSX. TCI did so principally by acquiring TRSs, which are a type of derivative contract in which the “short party” (usually a bank) agrees to pay the “long party” (in this case TCI) the cash flows associated with the underlying “reference” security position (here CSX common stock) – *i.e.*, any distributions the company pays to stockholders and any market appreciation of the stock. In exchange, the long party agrees to pay the bank a “financing” fee (usually computed as a spread over LIBOR on the notional value of the reference security position at the outset of the TRS contract) and any decrease in the market value of the underlying reference security position. Typically, short parties hedge their TRS exposure by purchasing the underlying security in amounts identical to those referenced in their TRS agreements, which is what TCI’s counterparties did in this case. By using TRSs, and later conventional ownership of stock (so-called “physical” ownership), TCI ultimately amassed a total economic exposure equivalent to roughly 14 percent of CSX’ outstanding common stock. However, TCI’s physical securities never exceeded five percent and TCI never filed a Schedule 13D based on its greater than five percent economic interest in CSX.

Unlike TCI, 3G directly purchased shares of CSX common stock, and at one point held roughly 4.4 percent of the outstanding shares. By mid-February 2007, TCI and 3G, having established their mutual interest in CSX, began direct discussions regarding each other’s activity relating to CSX. Between February and December of 2007, TCI and 3G frequently discussed CSX and, according to the District Court, coordinated their acquisitions and dispositions of CSX common stock and TRSs, as well as their preparations for a proxy contest with CSX.

In April 2007, TCI unwound some of its TRSs and purchased roughly four percent of CSX’ outstanding common stock. At that point, TCI and 3G held an aggregate “physical” position of roughly eight percent of CSX’ outstanding common stock – above the five percent threshold for filing a Schedule 13D if they were acting as a “group.”<sup>3</sup> However, TCI and 3G did not enter into a formal agreement to work together until December 19, 2007, and then only in the context of their contemplated proxy contest. On that date, TCI and 3G filed a Schedule 13D in which they disclosed that they collectively owned 8.3 percent of CSX’ outstanding common stock, that they intended to conduct a proxy fight and that TCI had TRSs with counterparties that gave it economic exposure to roughly an additional 11 percent of CSX’ outstanding common stock.

In early 2008, TCI and 3G filed their notice of intent to nominate directors, and later attempted to negotiate a resolution with CSX. The parties were unable to reach a settlement, and both sides filed proxy statements. TCI and 3G’s proxy statement supported the election of five dissident directors to the board and further proposed an amendment to CSX’ bylaws to allow any investor holding at least 15 percent of CSX’ outstanding common stock to call special meetings of stockholders for any purpose.

Following the filing of TCI and 3G’s proxy statement, CSX brought suit alleging that TCI and 3G had failed to timely file a Schedule 13D, and that the Schedule 13D and proxy statement were false and misleading. CSX sought, among other things, to enjoin the defendants from voting their shares at CSX’ 2008 annual meeting.

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## The Decision

The District Court addressed two issues: (1) did TCI “beneficially own” more than five percent of CSX’ common stock by virtue of its TRS holdings; and (2) at what point did TCI and 3G become a “group” for Williams Act purposes?

The District Court as a matter of first impression considered whether a holder of cash-settled equity TRSs “beneficially owns” the referenced securities held by the short party within the meaning of Rule 13d-3(a).<sup>4</sup> The Court observed that there were persuasive arguments for concluding that TCI exercised the requisite voting power and investment power to be deemed a beneficial owner. The Court noted that by virtue of the customary purchases executed by the intermediary “short” party in a TRS transaction, TCI knew its execution of TRSs would cause the counterparty banks to purchase CSX shares of common stock to hedge against their TRS positions, and likewise knew that it had the ability to cause the banks to sell their hedge shares when it unwound the TRSs. In the Court’s words, “TCI manifestly had the economic ability to cause its short counterparties to buy and sell the CSX shares.” With respect to voting power, the Court noted that TCI had eventually shifted the majority of its TRSs (which had previously been spread among eight banks) to two banks which, the Court found, would be more subject to TCI’s influence as a result of prior relationships and common interests. However, the Court ultimately found that it was not necessary to hold that TCI had “beneficial ownership” based solely on its TRS positions because it found that TCI clearly should be deemed a beneficial owner pursuant to Rule 13d-3(b), an anti-evasion rule.

Under Rule 13d-3(b), “[a]ny person who, directly, or indirectly, creates or uses a trust, . . . contract, arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of [S]ection 13(d) . . . of the Act shall be deemed . . . the beneficial owner of such security.” As it was undisputed that TCI’s cash-settled TRSs were contracts, the only elements left to determine were whether TCI entered into its TRSs for the “purpose of preventing the vesting of beneficial ownership” of CSX shares in TCI and “as part of a plan or scheme to evade the reporting requirements of [S]ection 13(d).” The District Court concluded that these elements would be present if it were demonstrated that TCI entered into the TRS transactions with the intent to create a false appearance that there was no accumulation of securities that might represent a potential shift in corporate control – or, in the words of the Court, to “conceal[] precisely what Section 13(d) was intended to force into the open.” The Court further noted that Rule 13d-3(b) was promulgated to prevent circumvention of the Williams Act’s disclosure requirements “where there is an accumulation of securities by any means with a potential shift of corporate control, but no beneficial ownership.”

The District Court found that TCI had, in fact, entered into the TRSs for the purpose of avoiding its reporting requirements under Section 13(d) of the Exchange Act and thus concealed its accumulation of CSX securities that might represent a potential shift in corporate control of CSX. The Court cited evidence that TCI’s CFO had told its board that one of the reasons for using swaps was “the ability to purchase without disclosure to the market or the company.” The Court also cited TCI emails discussing the need to make certain that each of its bank counterparties remained below the five percent reporting threshold. Additionally, the Court found that while TCI did make limited disclosures to CSX, and later the public, in advance of its December Schedule 13D filing, those disclosures were not sufficiently broad, timely or complete and further served TCI’s interest in permitting it to build its position without running up the price of the stock. Accordingly, TCI was deemed to be a beneficial owner of the shares of CSX common stock held by its counterparties to hedge their short exposures created by the TRSs. Based on this holding, the Court concluded that TCI had violated Section 13(d) by not filing a Schedule 13D when its TRS position in CSX first exceeded five percent of CSX’ outstanding shares of common stock.

The District Court next considered whether TCI and 3G formed a “group” earlier than had been disclosed, and therefore had not timely filed a Schedule 13D reflecting that status. Section 13(d)(3) of the Exchange Act provides that “[w]hen two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’” subject to the disclosure requirements of Section 13(d). When two or more entities or individuals fall within Section 13(d)(3)’s definition of a collective person, they are commonly referred to as a “group.” A group is deemed to have acquired beneficial ownership, as of the date of its members’

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agreement to act together, of all the equity securities of the issuer beneficially owned by each member of the group. Courts have repeatedly held that in order to constitute a group under Section 13(d), the members “must agree to act together for the common purpose of acquiring, holding, or disposing of securities.” The group’s agreement to act need not be in writing or in any other way formalized – an informal agreement proven through circumstantial evidence is enough. As explained by the District Court:

“...[T]he touchstone of a group within the meaning of Section 13(d) is that the members combined in furtherance of a common objective.’ In this respect, an allegation that persons have formed a group is ‘analogous to a charge of conspiracy’ in that ‘both assert that two or more persons reached an understanding, explicit or tacit, to act in concert to achieve a common goal.’ The requisite agreement ‘may be formal or informal, and need not be expressed in writing.’”

The District Court determined that TCI and 3G, despite acting without an express, written agreement were, in fact, a 13D group based on the circumstantial evidence of concerted action. The Court noted “[t]he likelihood that any agreement in this case would be proved, if at all, only circumstantially is perhaps greater than usual because the parties went to considerable lengths to cover their tracks.” In a revealing footnote, the Court stated that “[the defendant] testified that he was ‘particularly sensitive to the issue of groups and knowledgeable about when a group is formed and when it is not formed,’... and claims often to have begun conversations with other hedge funds, including 3G, by saying that the two parties were not a group.... Furthermore, when TCI approached the line between non-group and group behavior as it viewed it, it sought to limit any paper trail.” The Court went on to find that the circumstantial evidence quite convincingly implied that TCI and 3G acted in concert with each other from as early as February 13, 2007. Among other things noted by the Court: TCI and 3G had a close relationship for years and were known to regularly communicate with each other; TCI and 3G had multiple meetings and conversations in which they explicitly discussed CSX; 3G consummated rather sizeable trades in CSX TRSs and stock shortly after discussing CSX with TCI; and both funds had reduced their exposure in CSX (albeit by different percentages) during the same time period and later increased their positions and began looking for director nominees, again virtually simultaneously. Accordingly, the Court found that TCI and 3G should have filed a Schedule 13D as a group months earlier than they did.

Having found that the defendants had violated the Williams Act, the District Court then turned to the relief sought by CSX. The Court first found that there was a substantial likelihood of future violations and therefore permanently enjoined the defendants from committing any future violations of Section 13(d). With respect to CSX’ request to enjoin defendants from voting their shares at CSX’ June 2008 annual meeting, the Court found that CSX had not met its burden of showing irreparable injury, which was essential to the injunctive relief it sought. The Court noted that as a result of Second Circuit precedent requiring a defendant to acquire “a degree of effective control” of the outstanding shares of a company before it could show irreparable injury, it was unable as a matter of law to grant CSX’ requested relief. However, in an apparent signal to the Second Circuit, the Court stated that if it were free to do so on the grounds of deterrence or another basis, it would have granted CSX’ requested relief and enjoined the defendants from voting the shares acquired during the period in which they were in violation of their disclosure obligations.

In response to CSX’ emergency appeal, the Second Circuit denied CSX’ request for a preliminary injunction to prevent TCI and 3G from voting their shares (which currently represent approximately 6.4 percent of CSX’ outstanding shares) at CSX’ June 2008 annual meeting. Although the Second Circuit agreed to hear CSX’ appeal of the District Court’s denial of its requested relief on an expedited basis, this process will not commence until after the CSX June 2008 annual meeting, and the argument will not take place until August 2008.

### **Beneficial Ownership of Synthetic Positions in Destabilization Campaigns**

By holding that TCI amassed its TRS position as part of a scheme to avoid disclosure under Section 13(d) of the Exchange Act, the District Court has warned activist hedge funds that engage in synthetic equity trades with the purpose of influencing corporate control that their actions will be carefully scrutinized. It was not lost on the Court that TCI used its TRS position in its destabilization campaign to exert pressure on CSX, “a pressure that was enhanced by the lack of complete information.” As a result, we think it is possible that, unless the CSX case is overturned on appeal, activist funds utilizing synthetic equity in the future will treat their

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synthetic position as the equivalent of “physical” beneficial ownership in determining when a Schedule 13D filing is needed.

This new “transparency” should have the practical effect of mitigating the “ambush” type tactics utilized by TCI in the CSX contest, providing directors of target companies with more timely notice of significant accumulations, as well as a more comprehensive understanding of the economic forces at play in a destabilization campaign. Moreover, to the extent a target company is reasonably concerned that an investor may have a Section 13(d) reporting obligation based in whole or in part on “hidden” derivative positions, the precedential value of the District Court’s holding in CSX will provide strong support for a complaint alleging a violation of the Federal disclosure rules and for related (often useful) discovery.

Left open still after the Second Circuit’s refusal to “sterilize” the hedge fund shares at the CSX annual meeting is the availability of an adequate remedy for such Section 13(d) violations – a gap the Securities and Exchange Commission will perhaps fill either through rulemaking (as the issue has been under study recently at the Staff level) or through more comprehensive and timely enforcement actions.

### **Implications for “Wolf Pack” Activities**

There have been numerous recent examples of a successful destabilization campaign led by a hedge fund with a relatively small (often less than five percent) stake in the target company and based in large part on parallel investing and seemingly coordinated activities by other hedge funds. Although the members of these so-called “wolf packs” rarely sign a formal agreement, and almost never do so at the onset of their relationship, they often share ideas regarding the destabilization campaign and quickly accumulate stock positions in the target that, although small individually, are significant in the aggregate. The market’s knowledge of the formation of a wolf pack (either through word of mouth or public announcement of a destabilization campaign by the lead wolf pack member in a press release or Schedule 13D filing if the leader crosses the five percent disclosure threshold) often leads additional activist funds to enter into the fray against the target, resulting in a rapid (and often outcome determinative) change in composition of the target’s shareholder base.

Much of the potency of a wolf pack stems from the fact that its members typically do not report the formation and members of the wolf pack (along with the pack’s intentions and aggregate beneficial ownership of the target) pursuant to Section 13(d) unless they choose to do so for tactical reasons. This usually occurs only shortly before the wolf pack announces a proxy contest. By this point, the objective of Section 13(d) (affording timely notice to other investors and target companies of a material change in the shareholder base of a company) can no longer be achieved.

The District Court’s decision may constrain the most egregious types of coordinated activities, particularly the variants of parallel purchasing, both direct and synthetic, that are triggered by discussions and “postings” amongst activist investors. Coordinated but undisclosed activities in proxy contests are also likely to be constrained. Most importantly, greater transparency as to ownership and motives should result because the District Court’s decision, we believe, will require wolf packs to consider more carefully whether to file a Schedule 13D as a group, particularly in situations where the wolf pack does not believe there is a tactical detriment to disclosure of its existence. However, the decision is not a panacea. In the future, many activist funds that wish to avoid a Section 13(d) group filing may just be “smarter” in coordinating (or not obviously coordinating) their efforts to avoid creating sufficient discoverable circumstantial evidence that would allow a court to find concerted action. While it may no longer be sufficient to start meetings with the admonition that “we are not a group” and “to limit any paper trail,” activist funds will probably be more careful to avoid purchasing or selling securities contemporaneously, to avoid coordinated activities (such as searches for director candidates) before launching a proxy contest and to further limit what they say in emails and other discoverable communications.

Notwithstanding that activist funds may use the case as a road map of “how not to do it,” CSX does demonstrate the advantages a target company has in litigation if it is able to obtain discovery on an expedited basis. Although activist investors will try even harder to avoid the pitfalls of TCI and 3G, sometimes it is impossible to leave a “clean trail.” As a consequence, we expect that target companies will resort to litigation far more frequently than in the past, relying on the CSX case as legitimization for their Section 13(d) group claims.

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## Important Collateral Consequences for Defensive Planning

Many have commented that the lack of an effective judicial or administrative remedy for Section 13(d) violations (as demonstrated by the District Court's holding on remedies and the Second Circuit's ruling declining to sterilize the voting of TCI's and 3G's CSX shares), coupled with the time, attention and expense that a target company must be willing to devote to these types of cases, will lead some wolf packs to conclude that the consequences of coming out on the wrong end of a "CSX-type" holding is of limited practical consequence and will have little deterrent effect. However, the collateral consequences of a finding that activist investors constitute a Section 13(d) group, particularly when based upon the fairly common coordination flagged by the District Court, will materially change the landscape for many companies that have often otherwise felt defenseless in the face of hedge fund activism.

Consider the following:

- Activist investors found to have formed a "group" with aggregate beneficial ownership in excess of a poison pill's threshold will trigger the pill and cause massive dilution to the wolf pack's interests – we note that CSX did not have a poison pill, which otherwise would almost certainly have been triggered as a result of the District Court's rulings. The potentially enhanced deterrent effect of a poison pill as a result of the District Court's decision may lead companies, particularly those with smaller capitalizations, to think differently about the pros and cons of adopting or maintaining a pill notwithstanding the strong pressure from corporate governance activists to eliminate pills.
- State anti-takeover statutes, such as Section 203 of the Delaware General Corporation Law, that prohibit certain business combinations for a period after a person acquires more than a specified percentage ownership stake in a company without prior board approval from the target typically are based on "beneficial ownership" concepts similar to those used in the Section 13(d) context. A "group" finding would effectively preclude an acquisition of control for an extended period of time. While most wolf packs are not interested in engaging in a business combination with the target company (mitigating the defensive impact of this factor), some investors, particularly in smaller capitalization companies, do have such objectives.
- Activist investors found to be part of a "group" that beneficially owns more than 10 percent of the target company's outstanding shares could be subject to a disgorgement action under Section 16(b) of the Exchange Act, which requires that beneficial owners of more than 10 percent of a company's stock disgorge any short swing profits realized from any purchase and sale, or any sale and purchase, of any equity security within a six-month period.

Given the draconian economic or other consequences for activists of a "group" or "beneficial ownership" finding in these contexts, target companies may find the litigation path worthwhile pursuing both as a constraint on further coordinated activities during a campaign and for negotiating leverage in any settlement efforts with investors.

## Re-Examination of Takeover Defenses

Although the District Court's decision (assuming it is not overturned on appeal) will undoubtedly provide some assistance to public companies seeking to stave off an ambush attack based on cash settled derivatives or other forms of wolf pack aggression, we believe that it is prudent in light of the apparently increasing number of hedge fund destabilization campaigns for public companies to rethink some of their anti-takeover measures in light of "CSX-type" tactics, against which typical anti-takeover tools are largely ineffective. The District Court's reasoning and holdings in the CSX decision should provide directors with further support for implementing these protective mechanisms.

For example, two companies have recently put in place poison pills that include TRSs and other derivative securities when calculating beneficial ownership. Micrel, Incorporated adopted a poison pill on March 24, 2008 that included in determining the number of shares of common stock beneficially owned by a person any shares synthetically owned pursuant to any securities "that are the subject of a derivative transaction entered into by [the applicable] [p]erson, or derivative security acquired by such [p]erson, which gives such [p]erson the

economic equivalent of ownership of an amount of such securities due to the fact that the value of the derivative is explicitly determined by reference to the price or value of such securities, without regard to whether (a) such derivative conveys any voting rights in such securities to such [p]erson, (b) the derivative is required to be, or capable of being, settled through delivery of such securities, or (c) such [p]erson may have entered into other transactions that hedge the economic effect of such derivative.” Subsequently, Louisiana-Pacific Corporation amended its poison pill on May 23, 2008 to capture similar synthetic long positions.

Further, as we noted in our May 2008 **Corporate Governance Commentary**, “*Responding to JANA and Levitt Corp. and the Shadow Interests of Activist Investors*,”<sup>5</sup> we believe that stockholders have a significant interest in knowing whether the proponent in a proxy contest to elect directors or adopt shareholder proposals has an economic interest in the company’s stock consistent with its reported beneficial ownership. Because the current disclosure requirements of Regulation 13D and Regulation 14A do not elicit this information, we believe it would be reasonable for a board of directors to mandate disclosure of that information pursuant to the advance notice provisions of the company’s bylaws. Accordingly, we suggest that advance notice bylaws be adopted or amended to include provisions requiring a stockholder which seeks to nominate insurgent directors or present other proposals at a shareholders’ meeting to advise the corporation of the extent to which it is party to any arrangement, contract or understanding (such as derivative transactions and stock lending arrangements) pursuant to which the economic interests of the proponent in the company’s shares are either larger or smaller than its reported beneficial ownership. Information concerning other financial incentives associated with the proponent’s equity position, such as fees or profit sharing arrangements, might also be elicited and disclosed, as well as other information relevant to shareholder voting decisions, through expansion of the informational requirements of today’s conventional advance notice bylaws.

## Postscript and Conclusions

Despite the District Court’s findings of questionable behavior on the part of TCI and 3G, RiskMetrics has come out in support of four of the dissident nominees. Its take on the District Court’s decision follows:

“In our opinion, the court unfairly singles out TCI and 3G as part of a larger indictment of common industry practice. As such, the Section 13(d) swaps ‘issue’ does not impact our analysis of this proxy contest. With respect to the court’s finding that TCI and 3G formed a ‘group,’ we note the court’s ruling is based on circumstantial evidence and that the court found no irreparable harm from the violation of the disclosure rules.”<sup>6</sup>

Thus while CSX will undoubtedly prove to be a useful weapon in a target’s arsenal against the predatory behavior of a wolf pack, how much it will affect future destabilization campaigns remains to be seen.

As discussed above, there are other actions that companies have begun to take to protect themselves, particularly with regard to derivative transactions. We believe that this trend will continue, and that the District Court’s decision has set forth a valuable predicate for boards of directors to reevaluate their anti-takeover defenses. Appropriate expanded advance notice bylaw provisions, as well a poison pill with broader spectrum “venom,” should alter a potential target’s vulnerability to some of the tactics commonly practiced by activist hedge funds and, in at least some cases, deter a destabilization campaign or help alter its outcome.

If you have any questions about this *M&A Commentary*, please contact one of the authors listed below:

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1. *CSX Corporation v. The Children's Investment Fund Management (UK) LLP, et al.*, No. 08 Civ. 2764, 2008 U.S. Dist. LEXIS 46039 (S.D.N.Y. June 11, 2008). The authors would like to thank Colin Bumby and Jaron Shipp, associates at Latham & Watkins, for their assistance in preparing this *M&A Commentary*.
2. Under the Williams Act, any "beneficial owner" of more than five percent of a class of equity securities registered under the Securities Exchange Act of 1934 (the "Exchange Act") must file a Schedule 13D with the Securities and Exchange Commission within 10 calendar days of crossing the five percent threshold.
3. TCI also held at that time TRSs giving it economic exposure to an additional roughly 10 percent of CSX' outstanding common stock.
4. Rule 13d-3(a) promulgated under the Exchange Act provides that "a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) voting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) investment power which includes the power to dispose, or to direct the disposition of, such security."
5. Available at: [http://www.lw.com/upload/pubContent/pdf/pub2203\\_1.pdf](http://www.lw.com/upload/pubContent/pdf/pub2203_1.pdf).
6. RiskMetrics Group, Risk & Governance Weekly, June 20, 2008. RiskMetrics goes on to state: "The fact that the court found some of the testimony of TCI and 3G to be 'not credible' has only a minimal effect on our analysis. TCI and 3G are expected to appeal the decision. To date, no law enforcement agency has brought perjury charges against the dissidents. We note that a finding by a judge that testimony is not credible is subject to a much lower evidentiary burden than is a criminal charge of perjury. CSX cannot claim that TCI and 3G have been 'proven' to have lied on the stand. To the extent that a criminal enforcement action is brought against TCI or 3G, we would of course revisit our vote recommendation. Based on the record, we cannot conclude that the behavior of TCI and 3G has been particularly egregious or, when balanced against what in our opinion would be the positive effect of the presence of dissident directors on the CSX board, that such behavior should preclude our support for members of the TCI/3G slate."

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Latham & Watkins has also prepared a Client Alert entitled "*Use of Total Return Swaps in Control Contest Leads to Deemed Beneficial Ownership of Underlying Shares*" addressing aspects of the CSX decision that are likely to be of particular interest to participants in the derivatives industry.

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