Proxies & Class Actions

Harold Hallstein IV

Undoubtably, most of our clients have heard the statement, "the United States is a litigious society." In fact, according to the New York Times, the US is the most litigious society in the world, with ~2.2% of GDP being spent on tort litigation – implying a "market" for litigation of ~$440 billion per year – nearly $1,500 per American.

Leaving any personal opinions on the general topic by the wayside, our firm must focus on our role as client fiduciaries first and foremost. There are many elements to that role. Perhaps the most fundamental is our position as client proxy for corporate actions that are put to shareholders by management, or which shareholders place on annual meeting or special ballots. We have the ability to vote client shares on items including, but not limited to, board of director appointments, audit service contracts, compensation related issues, and all manner of shareholder-initiated questions which increasingly have social responsibility elements. I would describe these activities as the foundation of our efforts as investors to keep our hired corporate managers honest, competitive, and thoughtful about long-term value to society.

However, unfortunately, there are also times when shareholder lawsuits become necessary to hold unscrupulous managers to account – when laws have actually been broken. As you might imagine, these types of lawsuits tend to come in waves during periods of major market declines, but they are constantly ongoing and have been generally increasing over time as the number of listings around the world expands.

According to Stanford Law School's *Securities Class Action Clearinghouse,* the tech bust of 2001 saw the peak number of cases at 498. 2017 was not far off those historic highs at 411 cases. Current ongoing cases in 2021 include claims against Peloton Interactive, Zillow, Facebook, Goldman Sachs, Coinbase, Bristol-Myers, and many other firms you probably know. Below you can see a brief overview of this class action universe according to Stanford Law, and the current open case profile:

2001	498
2017	411
2018	402
2019	402
2020	320
2016	271
2002	265
1998	242
2004	239
2003	228
2008	223
2000	216
1999	209
2015	208
2011	188
2021	187
2005	182
2007	177
2010	175
1997	174
2014	168
2013	165
2009	164
2012	151
2006	121
1996	110

CASE DISMISSED	2894
CASE SETTLED	2671
CASE ONGOING	497
CASE REMANDED	25
CASE REACHED TRIAL VERDICT	9

IPO Allocation	313
Credit Crisis	205
Analyst Malpractice	68
Option Backdating	40
Mutual Fund Market Timing	26
Madoff-Related Cases	24
Bid Rigging or Insurance Kickbacks	9
MeToo	3

Tracking these cases and participating in each eligible class is a significant amount of work, especially when you represent numerous shareholders with even more numerous investments. As a result, we have sought out a partner and technology to help us in that work. The company is called *Chicago Clearing Corporation* *(CCC),* and they coordinate class action filings for firms like ours. In brief, CCC will monitor our trading data, cross reference their databases, and when we have held shares in any "class window" they will file our shares on a contingency basis for 15% of any settlement, depositing net settlements back into relevant client accounts.

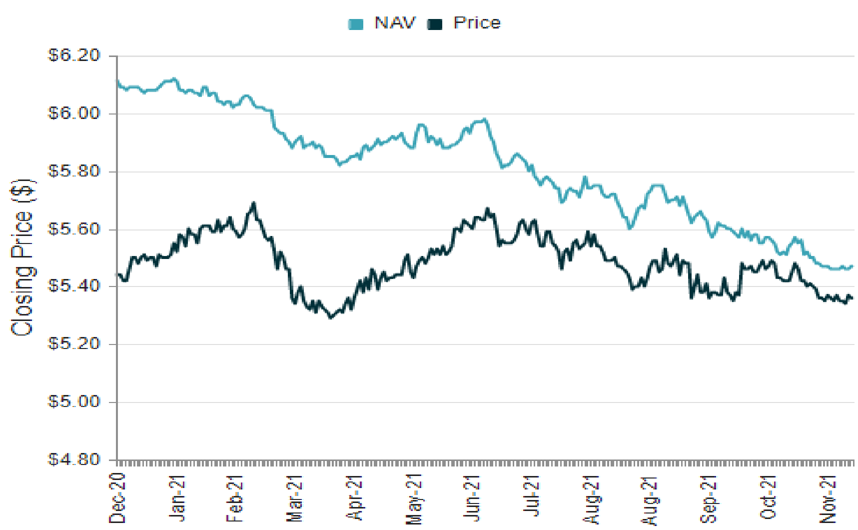
Implementing this service for our clients only requires modification to our *Privacy Policy* and regulatory disclosures, which we have included in the email carrying this letter. While we see this as a smart service addition for all clients, we also understand some clients may prefer not to participate, and they are welcome to opt out by notifying us at any time in writing.

To keep the remainder of this letter interesting and informative, I'd like to highlight two instances where proxy and class fiduciary activities created value so you can better understand how our work in this realm functions in both theory and practice.

Example 1 – Value in Shareholder Proxy Activism

One recent situation where we took an active role in shareholder activism related to the Templeton Global Income Fund (GIM). In brief, this global fixed-income fund had been trading below the value of the assets it owned (NAV) for quite some time, making it an attractive way for our firm to access the non-USD fixed income asset class. In short, we could buy bonds through this fund for materially less than those same bonds could be bought via the bond market:

Figure 1. Templeton Global Income Fund – Trading Price vs. NAV



Then, in late 2020 and early 2021, a hedge fund called Saba Capital Management saw the same opportunity and began accumulating shares, ultimately buying 30 million of the ~134 million shares outstanding, or ~22% of all the shares, and therefore votes.

Before long, we had an impressive stream of envelopes arriving in our mailbox, from both the management at Templeton and Saba Capital. As it turned out, one of the analysts from Saba was a Bates College alumni, and I was able to get him on the phone not only to discuss their plan, but also to remind him my *alma mater*, Colby College (bitter rivals) is better in every single regard. While we were forced to agree to disagree on that, we did resolve to join forces for an opportunistic moment, and I committed our shares/votes for the board representatives Saba was seeking to elect, and also a measure to modify the fund's corporate documents to compel the repurchase of shares if the discount of the trading price to NAV continued to be unusually wide. That would in effect legislate a slow closure of the fund over time, something Templeton was resisting adamantly as it would be the slow loss of that business to them.

Long story short, with our help, four Saba representatives were elected to the board, and while the exact corporate structure modifications promulgated by Saba were rejected, Templeton was pressured into launching a very large self-tender (buyback) that was instrumental in driving the trading price discount down from a 52 week high of 11% to a 52 week low of 1% during the period pictured in *Figure 1* – please see the lines converging.

In the final reckoning, this investment was not especially successful as the asset class of bonds happened to be quite weak in the period, but materially more return was able to be extracted from the fund than would have been accessible by owning the bonds themselves, which was a success in terms of the core underlying hypothesis.

Example 2 – Value in Shareholder Class Action Lawsuits

We have generally been fortunate to have avoided a lot of class action lawsuits in our investments, but one does stand out uniquely from my earliest years in the asset management industry. In 2007, Blackstone Group, the New York based private equity firm, sold partnership "units" to the public for the first time in an IPO that placed 12.3% of the firm for $4.13 billion.

At that time, Blackstone had just acquired Hilton Hotels for $26 billion, which turned out to be essentially the "high water mark" for super-sized private equity deals. Due to the reputation the firm had as being the savviest operator on Wall Street, it felt important to many investors – myself included - to own these newly public shares. I figured I would learn a great deal simply from reading their offering prospectus and following their news flow. The offering was structured as a "publicly traded partnership" quite different from any offering done in that industry before, and I was curious about the structure.

Well, I did learn a lot, and the primary lesson really stuck with me: if something looks and feels overly complex and you're not 100% sure you understand – you almost certainly do not!

Blackstone units, which started trading during the IPO at $31, promptly fell to below $10 during the great deleveraging of the financial crisis in 2008-2009. While those units now trade at 4x+ the offering price ($134), at the time it appeared the firm's founders Steve Shwartzman and Pete Peterson had made out far too well for themselves, and a class action was filed accusing them of not adequately disclosing investments which had already been impaired by weaking financial conditions, and not adequately clarifying how their fund investors had the ability to "claw-back" fees paid to Blackstone in the past.

Making this *very long* story short, 5+ years later in 2013 Blackstone settled for $85 million. I remember when my check came for a few hundred dollars. It didn't mean much financially, as the economic recovery was well underway by 2013, but it meant something in terms of closure, making me think I wasn't 100% wrong for investing in something more complex than I really understood – maybe I was only 90% wrong since they didn't disclose everything they were required to by the SEC in that tome-like prospectus.

Humorously, because they settled and did not go to trial, Blackstone never actually admitted to breaking the law or wrongdoing. However, investors can and should take some solace in the fact that managements live with similar or greater worries about private class investors as they do to about their direct government regulators. The system keeps churning along, and some value does exist as various wrongs are righted – even if it takes half of a decade or more.

Based on Stanford Law's data presented earlier, almost half of all cases are settled and damages are therefore paid. **Critically, those settlements are only divided among those investors who actually file their eligible class shares**. We have made the fiduciary decision to always be on that list of best organized investors—for each client and each share—no matter how trivial it might feel.

Best,

Harold A. Hallstein
Sankala Group LLC
T: (720) 310-0605

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