

Tension in the Wolf Pack: Marcato Capital Criticizes Sotheby's Board of Directors

By Richard Johnson, J.D. Candidate 2017 | March 12, 2015

Richard (Mick) McGuire, founder of the San Francisco hedge fund Marcato Capital Management LP and holder of 7.4 percent of [Sotheby's](#) shares, [recently sent a letter](#) to the company's board of directors, accusing the management of "willful neglect" and demanding an immediate \$500 million share repurchase and replacement of the chief financial officer.

McGuire's letter was revealed in a Schedule 13D filing with the Securities and Exchange Commission. Under Section 12 of the Securities Exchange Act of 1934, a person or group that acquires more than five percent ownership of a company is [required to file](#) a 13D to discuss their intentions with the company. If these intentions change, the person or group is required to amend the 13D filing, [and it was through such an amendment](#) that McGuire's letter came to light.

In one sense McGuire's remarks were unsurprising because Sotheby's has come under significant criticism lately. Starting in January of 2014, McGuire and fellow hedge fund activist Dan Loeb [pressured the company publicly](#) to return capital to shareholders. Although McGuire demanded \$1 billion, Sotheby's agreed to \$325 million in hopes of appeasing the tandem. In addition to returning the capital, however, the auction house also adopted measures [designed to shield the company](#) against a possible "proxy fight" from Loeb and McGuire's hedge funds, which are Sotheby's largest and second-largest shareholders respectively.

A "proxy fight" is the solicitation of stockholder votes to campaign against management of a company for control or board representation. [Proxy solicitations have increased dramatically](#) in recent years, which according to [Wilson Sonsini Goodrich & Rosati P.C.](#) is largely the result of 1999 revisions to the governing regulations, "allow[ing] dissidents broad latitude to agitate." Securities commentator [Rachel Posner](#) also addressed this trend, noting that companies should be particularly cautious of hedge fund "wolf packs" grouping up to increase proxy leverage.

Sotheby's concerns of a proxy fight [manifested last spring](#) when Loeb's hedge fund, Third Point LLC, initiated a proxy battle for representation on the board and removal of the company's chairman and chief executive. McGuire supported Loeb's fight and [many saw them as complementary players](#). Loeb eventually settled his proxy fight in return for three seats on the board and the CEO's resignation.

Given McGuire's active support for Loeb's position on the board, [some](#) have wondered if the recent letter criticizing management indicates a rift between the prior wolf pack. [Others](#) have gone so far as to say that the letter suggests a "subtle point being made that perhaps Loeb . . . joined the board and then he was supportive of the folks he was serving with."

These points underlie a broader debate about whether activists actually protect the interests of shareholders through proxy fights or hurt the companies by leveraging shareholder dissent into personal gain. It seems counterintuitive that one of the cited reasons for the increase in proxy

fight is the “[shortened investment horizon of many investors](#),” and yet the immediate impact of Loeb’s proxy fight has been financial hardship. In particular, Sotheby’s just released its fourth quarter 2014 earnings and its net income was down 9 percent from the previous year. More importantly, [the company attributed](#) the drop to the \$21.4 million cost of the proxy dispute with Loeb - \$10 million of which went to Loeb as reimbursement for expenses incurred – and the \$7.6 million severance package given to the ousted CEO, whom has yet to be replaced.

McGuire’s recent criticism may be valid, but removing the company’s CFO without first replacing the CEO is [seen by some](#) as impatient. At the very least it indicates disappointment with the direction of the company since Loeb’s appointment. How Loeb’s presence on the board shapes Sotheby’s moving forward, however, ought to shed significant light on the motives of his proxy fight, as well as the status of the wolf pack.