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What's on Your Mind?

Join Our Continuing Peer-to-Peer Exchange Exploring the Latest Corporate Governance Trends

Institutional Shareholder and Investor Relations Best Practices
November 14, 2012
9:15 a.m. – 10:30 a.m.

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Panelists: Phillip M. Goldberg, Richard H. Grubaugh, Janice Hester-Amey, Matthew Halbower, Elizabeth Saunders, John K. Wilson

Time: 9:15 a.m. to 10:30 a.m.

1. Issues and Developments Impacting Shareholder Relations

Economy

- Strong 2012 stock market performance despite lingering fears of an increased global economic slow down (especially in developing markets)

Shareholder Proposals, including Say on Pay

- Many of the shareholder proposal trends from 2011 continued into 2012, with similar passage rates and approval percentages from shareholders

Rising Importance of Social Media

- There has been an increased focus on a company's role in monitoring, managing and engaging in a company's activities on social networks like Facebook and Twitter

Political Contributions

- There has been a significant increase in the amount of political contribution shareholder proposals (spurred on, in part, by *Citizens United* - the 2010 Supreme Court decision that allowed virtually unlimited campaign contributions by companies and unions)

Continued Importance of Diversity on Boards of Directors

- While shareholders have continued to seek greater race and gender diversity on boards of directors, shareholders have increasingly been calling for the election of directors which are representative of all shareholders (i.e., not just a select set of large shareholders or founders of a company) (e.g. Facebook)

Sustainability

- A continued belief by a growing number of investors that a company's social and environmental policies correlate strongly with its financial performance

2. Shareholder Proposals[1]

Overview

- 2012 saw a continuation of long standing trends in corporate governance, with approval rates staying high among investors for long-standing issues such as majority vote requirements in uncontested board elections and declassification of board proposals
- Say on Pay continues to be investors' primary instrument for expressing compensation concerns
- ISS is no longer the only important arbiter of governance; Glass Lewis has been gaining influence among institutional investors

[1] Statistics in this section are from D.F. King & Co., Inc., *2012 Proxy Season Review – Trends and Highlights;* Eagle Rock Proxy Advisors, *Corporate Governance: Observations & Trends from the 2012 Proxy Season*.

Compensation Practices

- "Say on Pay" – Shareholder advisory vote on compensation
  - Average support for Say on Pay in 2012 remained relatively high (90% vs. 91% in 2011)
  - A total of 53 proposals failed to obtain majority shareholder support in 2012
  - The majority of companies that had issues with failed or almost failed votes from 2011 improved their shareholder approval percentages significantly, and in large part, passed their 2012 Say on Pay votes comfortably
  - Companies making positive changes
    - 63% of companies that received an "Against ISS recommendation" in 2011 received a "For" recommendation in 2012. These companies obtained a 27% increase in average support (66% to 93%)
  - Companies in the clear in 2011, in trouble in 2012
    - 72% of companies that received an "Against ISS recommendation" in 2012 had received a "For" recommendation in 2011; these companies suffered a 28% decrease in average support (92% vs. 64%)
  - ISS issued "Against" recommendations on 14% of Say on Pay proposals in 2012 (compared to 12% in 2011)
- Increase in response rate to negative ISS recommendations
  - More companies responded to negative ISS recommendations on Say on Pay in 2012
    - 41% filed additional materials in response to a negative recommendation (compared to 17% in 2011)
  - In refuting the ISS analysis, the most common argument made by companies related to flaws in ISS' peer group methodology
  - ISS has indicated plans to change its peer selection methodology in advance of the 2013 proxy season

Board Matters

- Majority voting
  - Approximately 35 proposals in 2012, compared to 36 in 2011; vote averaged 62%, compared to 59% 2011
  - According to ISS, 79% of companies in the S&P 500 have majority voting in some form or fashion (including director resignation policies not officially adopted as bylaws)
- Separate Chairman and Chief Executive Officer
  - Independent Chairman proposals went to a vote at more meetings in 2012 than any other shareholder proposal
  - Approximately 56 proposals in 2012, compared to 28 in 2011; support level increasing – 4 proposals received majority support in 2012

Elimination of Takeover Defenses

- Repeal staggered boards
  - 47 proposals in 2012 compared to 39 in 2011; vote averaged 81%, which is up from 73% in 2011
- Right to call special meetings
  - Many proposals omitted due to management submitting its own special meeting proposal
  - Greater support for proposals to adopt new right than to lower threshold on existing right

Political Spending

- Three main proposals regarding political spending by companies that companies faced in 2012:
  - Political Disclosure and Oversight (i.e., requires companies to increase disclosure of political spending as well as policy considerations regarding how future political contributions will be made (most prevalent))
  - Disclosure of Lobbying Payments
  - Say on Political Spending (i.e., an up or down vote on Political Contributions, similar to Say on Pay proposals)
- While no political spending proposals passed in 2012, 19 received 30% or higher support levels (for/against)
- Reflects a greater concern, on the part of at least some investors, that the political activities of companies be up front, well thought out, and transparent

Report on Sustainability

- 2012 support for sustainability reporting proposals was largely on par with 2011 results, with 10 proposals in 2012, compared to 9 in 2011; vote averaged 32%, which is down from 33% in 2011

Proxy Access

- Proxy Access is intended to allow qualifying shareholders to require the company to add to the ballot a certain number of directors without engaging in a proxy fight. The SEC originally attempted to set these qualifications at 3% of outstanding shares for 3 years. After the courts struck this rule down, the SEC left proxy access to be determined by each individual company, in a process known as private ordering
- In 2012, 25 proxy access proposals were submitted and 9 went to a vote. The average overall support was 35.2%
- Nabors Industries and Chesapeake Energy were the first two companies to have proxy access receive majority support

3. Sustained Shareholder Activism

Institutional Shareholders

- Institutional shareholders continue to make their views known through:
  - Say on Pay Votes
  - Withholding votes for directors
  - Shareholder proposals
  - Corporate governance ratings
  - Direct communication with company executives and directors

Hedge Funds

- Hedge funds have taken on role as investors, not just traders – activism as investment style
- Hedge fund activism can take different forms:
  - Challenging management and boards of directors to review business strategy
  - Pursuing increased dividends or stock repurchases or a restructuring, breakup or sale of a company
  - Launching hostile takeovers and proxy contests
  - Blocking a sale transaction to force the acquiror to pay a higher price

- Hedge funds often act in parallel using "wolf pack" tactics
- Hedge funds and other activists no longer viewed as "raiders" but as "corporate activists" promoting shareholder interests

4. Public Company Preparation for Activist Shareholders

- Maintain a response team and appropriate corporate policies
  - Establish response team and maintain current contact list
    - Key officers: CEO, CFO, CLO, investor relations, others
    - Advisors: legal counsel, financial advisor, investor relations and proxy solicitor
    - Board of directors
  - "No comment" and sole spokesperson policies
    - Avoids duty to disclose third party overtures
    - Ensures company speaks with one voice – typically through CEO
    - Scripted responses to different approaches
- Board should be prepared to deal with an activist situation
  - Annual review, including investor relations, strategic plans, takeover defenses, M&A market review, etc., with participation of financial advisor and counsel
  - Board needs to understand strategic plan and potential strategic alternatives
  - Be prepared to call special board meeting on short notice (e.g., 24 hours)
  - Board members need to be prepared to respond to both formal and informal communications from activists
- Investor relations is key
  - Proactively communicate company strategy and explain reasons for any performance shortfall (though SEC disclosures, press releases, website disclosures, industry conferences, etc.)
  - Monitor significant stock holdings and trading
    - Identify potential problematic shareholders
  - Review analysts' reports for opinions that may appeal to activist shareholders
  - Understand alternatives that activists may propose so the company can respond accordingly: share buybacks, special dividends, sale of company/division, spin-off or other restructuring
  - Maintain open communication with institutional shareholders and respond to all shareholder inquiries
    - Watch Regulation FD issues

5. Public Company Responses to Shareholder Approach

- Approaches typically private, but can be public through Schedule 13D
- No duty to disclose unless leak of information by company personnel
- Generally no duties to discuss, negotiate or meet with activist
- Decision of whether to meet with activist made based on case-by-case basis; consider confidentiality and standstill agreement if meeting with activist
- Monitor stock activity and maintain contact with large institutional investors and proxy advisory firms
- Goal to avoid public announcement or "wolf pack" attack that puts company "in play"

6. Best Practices to Eliminate Impact of Economic Forces Beyond a Company's Control

- In 2012, many companies were frustrated that their share price appeared to be out of their control as macroeconomic factors seemed to dominate investor decisions
- It is important to focus investors' attention away from those economic forces beyond a company's control
- To get this message across, companies should:
  - Be specific about where growth will come from (beyond the usual mantra that cost cutting and greater efficiency will lead to greater growth)
  - Give enough guidance to help equity analysts create appropriate financial models so that such equity analysts can correctly value the company
  - Find the right investor base
    - Investor Relations personnel should be locating and targeting investors whose portfolios suit a company's valuation, capitalization, and geographical region to secure buy-and-hold investors who often make shares less volatile
    - A 2012 survey found that approximately 84% of Investor Relations personnel reported engaging in investor targeting for their company, and 82% saw results in one year or less[2]

[2] CFO Magazine, *Start Spreading the News*, dated September 1, 2012.