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REPORT

Board Communication

Boards Engaging Investors This Season Need to Explain Pay, Be More Accessible

■ *Practice Tip:* Corporate boards this proxy season need to play a stronger role in reaching out to shareholders by providing access to independent or lead directors and by being ready to explain how their company's overall compensation philosophy affects shareholder returns and value creation in the current down economy.

In an economy that is seeing a dramatic increase in shareholder discontent, corporate boards must be proactive and home in on executive compensation and risk—two of the top issues for shareholders this proxy season, securities lawyers and consultants participating in a Feb. 24 Foley & Lardner LLP Web conference said.

Among the most popular proxy issues for shareholders right now are compensation and risk—especially in underperforming companies, Richard A. Grubaugh, a senior vice president of proxy solicitation and corporate communications firm, D.F. King & Co., Inc. in New York, said.

"In this economic environment, there is a significant lack of trust of corporate boards and management mostly in the financial industry, but in other industries as well," John Palmer, a founder of financial sector partnership management firm PL Capital LLP, said. "The more information a company can provide to investors—institutional investors especially—the better off it will be," he said.

To address many of the corporate governance issues raised by shareholders, it is critical that companies make good investor relations and "good listening" a priority so that engagement with shareholders happens on ongoing basis, a Feb. 1 Gibson, Dunn & Crutcher LLP publication on considerations for public company directors in the 2010 proxy season said.

Compensation and Risk Are Popular Concerns. To win over governance discussions this year, companies must be able to explain how their overall compensation philosophy affects stockholder returns and value creation, Grubaugh said. "I believe companies will be seeing a lot more equity plans being put to shareholder votes this year. A greater than normal number of these plans will likely receive 'against' recommendations from proxy advisory firms," he said.

Companies need to pay attention to the recommendations provided by proxy advisory firms, such as RiskMetrics Group and Glass Lewis & Co., Grubaugh said. "Many companies try to win the approval of these advisory firms, but are currently at the point where they will not be able to win their support. Companies should consider establishing a relationship with them by taking their messages directly to the institutional holders," he said.

Key Steps for Engaging Shareholders.

Securities lawyers and consultants participating in a Feb. 24 Foley & Lardner LLP Web conference suggested key actions directors can take to engage shareholders this proxy season:

- Make good investor relations and listening a priority;
- Be able to explain how overall pay philosophy affects value creation;
- Pay attention to proxy advisory firm recommendations;
- Provide access to independent or lead directors; and
- Understand the concerns of institutional investors versus retail investors.

"Many of the portfolio managers at the leading institutional investor firms do not focus on compensation in the same manner the government does. Companies must be prepared to justify their compensation programs and be able to communicate directly with these portfolio managers," he said. "Many portfolio managers have the capability to override some of their firms' governance stances. However, they need to love a company enough before they will even consider doing so," he said.

To the extent a company conveys other information, such as guidance to investors on how its business model performs—including plans for capital spending and other priorities, it should include a "forward looking" disclaimer statement to protect the company from securities law liability, John Wilson, a securities law partner with Foley & Lardner LLP in Milwaukee, Wis., said in the conference. The statement should be updated on a regular basis, he said.

Shareholders Seek Independent Directors. Not only are investors looking for more detailed information about companies, but they are also seeking access to independent board directors, Palmer said. "We have already seen this discontent in the banking industry in relation to executive bonuses," he said.

"Investors want directors on boards who are willing to listen and respond to their concerns. They do not want their message, comments, or views of the company to be filtered by, for example, the chief executive officer or chief financial officer of the company," Palmer said.

Access to all directors may not necessarily be what investors need, Palmer said. Investors are looking for access to lead directors and other "key players" of the company, he said.

Companies must be proactive, especially while conducting business in the currently volatile capital markets, Jason M. Wortendyke, an executive director at UBS Investment Bank in Chicago, said.

"It might be helpful for companies to provide analysis to investors that is 'scenario based' rather than give firm guidance through the income and cash flow statements," he said. This provides companies and investors with an "industry number" they can use to make assumptions and generate guidance for the future, Wortendyke said.

"This also allows companies to put out metrics which will show the operating leverage in the business and benefit of the cost reductions or restructuring that have been done during the crisis, while not putting the company 'on the hook' for not providing specific numbers," he said.

Directors Need to Participate More Actively. Boards need to be attentive to what their companies are doing to better respond to shareholder concerns, and recognize that—more than in the past—directors may need to play a stronger role in reaching out to shareholders, the Feb. 16 Gibson Dunn publication said.

According to the publication, "Board-level involvement in shareholder engagement can generate goodwill and avoid a situation where shareholder exposure to the board and its work is limited to the annual meeting context."

Proper communication with shareholders can help companies educate shareholders and other stakeholders about, among other issues, the nature of the board's oversight role, the publication said. "The board should consider what the company is doing to communicate effectively and regularly with shareholders, the business press, and analysts about the company's business and strategy, including the role that the board plays in overseeing these critical areas," it said.

According to the publication, in communicating with shareholders, companies should strive for transparency while at the same time being sensitive to confidentiality concerns. "At a meeting of the SEC's Investor Advisory Committee in July 2009, there was some consensus that the SEC should issue guidance clarifying that dialogue between boards and shareholders on corporate governance matters is acceptable under Regulation Fair Disclosure, which prohibits the selective disclosure of material nonpublic information," it said.

Institutional Investor Concerns Are Important. In the case of institutional shareholders, "it is important to know how closely these shareholders follow the recommendations of the major proxy advisory firms," the publication said.

It may be helpful for companies that take recommendations of major proxy advisory firms into account but do a case-by-case analysis in making voting decisions to reach out to institutional shareholders, the publication said. This way the company might be able to avoid a negative vote on a director or a shareholder proposal, it said.

The current economic environment presents an opportunity for companies to be proactive in discussing the steps being taken to manage risk and the board's role in overseeing this process, the publication said.

"Looking ahead to the upcoming annual meeting, the board should be comfortable that the company knows its shareholder base and that the company is anticipating areas of potential shareholder concern and how to address them," the publication said. "The company should have an understanding of what proportion of its shareholders are institutional as opposed to retail, who the largest shareholders are, and how long they have held the company's stock," it said.

"The board should consider the company's strategies for engaging, or enhancing engagement, with its largest shareholders," the publication said. Furthermore, "it is important to recognize that proxy voting decisions at institutional shareholders often are not handled or influenced by the portfolio managers and analysts with whom management engages at industry conferences and during earning calls, but instead are often handled by separate personnel at the institution," it said.

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The Gibson Dunn publication is available at http://www.gibsondunn.com/Publications/Pages/ConsiderationsPublicCompanyDirectors2010.aspx.

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