Skadden

CORPORATE GOVERNANCE SERIES

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Shareholder Activism and Engagement

On January 14, 2014, Skadden presented a seminar titled "Shareholder Activism and Engagement" as the second program of our three-part corporate governance seminar series. Panelists included Stephen L. Brown, senior director, Corporate Governance, TIAA-CREF; Joele Frank, managing partner, Joele Frank, Wilkinson, Brimmer, Katcher; Abe M. Friedman, managing partner, CamberView Partners; and Richard J. Grossman and Marc S. Gerber, partners in Skadden's Mergers and Acquisitions Group.

Shareholder Activism Overview

After a brief introduction by Marc Gerber, Rich Grossman provided an overview of recent trends and developments in shareholder activism which include an uptick in activity against management and boards of public companies; large amounts of dry powder enabling funds to target larger-cap companies; and an increase in sympathetic media attention to activist campaigns. Activists also are displaying increasing levels of sophistication by running more professional campaigns, hiring top financial and legal advisers, and nominating more qualified candidates to boards.

There also is a number of newer activist funds that Rich identified as "Son of Activist" funds. These are younger, smaller funds run by individuals who previously worked for successful activists such as Carl Icahn and Bill Ackman.

Perhaps the most significant activism trend is the growing amount of support that activists are receiving from institutional investors. Traditional long-term shareholders are increasingly willing to support an activist if they are dissatisfied with a company's performance. Some are even encouraging activists to initiate campaigns at underperforming companies in their portfolios.

The other panelists commented on these trends as well, noting that a shift is occurring in the relationships between companies and investors. Stephen Brown called this a "game-changing moment in time." Abe Friedman explained that more and more companies are reconsidering how they relate to their investors and are developing a better understanding of the importance of those relationships.

The panel also commented on the drivers of activism. While activists' agendas are often M&A-driven, Rich noted that they are increasingly focused on perceived weaknesses and vulnerabilities in companies. These include operational underperformance compared to peers, large amounts of excess cash, an under-leveraged capital structure and divestible non-core assets. Activists also are emphasizing governance weaknesses in companies, focusing on board composition, executive compensation and corporate governance policies that they may argue are not in the best interests of shareholders.

Finally, the panelists discussed how companies may know if an activist is approaching, noting that activists surface in a variety of ways other than a Schedule 13D filing. Joele Frank emphasized the need to monitor who is calling the investor relations department, participating on earnings calls and accessing company webcasts.

Governance Activism

Marc shifted the discussion to governance matters. Beginning with director elections, he explained that the vast majority of directors are elected with over 90 percent voting support. Close votes, even if sufficient to elect a director, signal a lack of support and, recently, have been followed by director resignations. Such votes are more likely to occur when a public vote-no campaign is run, as was the case for directors at Hewlett-Packard and JPMorgan Chase in 2013.

The panel then examined why directors might fail to receive shareholder support. The most common reason at larger companies is directors' failure to implement a majority-supported shareholder proposal. Abe discussed how these proposals are part of what might be considered "lower-case-a activism," rather than the high-profile "Activism" typically associated with proxy contests. This lower-case activism is frequently considered merely a nuisance to companies, but it should not be dismissed or ignored. Disregarded shareholder proposals can lead to support for more serious Activist campaigns. The panelists stressed that it is crucial for companies and boards to engage with shareholders and explain if the implementation of a proposal will differ from the proposal itself.

Other reasons why directors may fail to receive shareholder support include poor attendance at board and committee meetings, the adoption of a poison pill with a term greater than one year without shareholder approval, the failure to act on concerns generating opposition in previous director elections, service on too many boards, and status as an "Affiliated Outside Director" while serving on the audit, compensation or nominating committees.

The panel next examined specific governance provisions and issues that frequently attract shareholder attention. Speaking as an institutional investor, Stephen expressed support for board declassification as well as a majority voting standard for director elections. When asked about a plurality voting standard when combined with a resignation policy, Stephen was not enthusiastic.

The panel also discussed the role of an independent chair versus that of a lead independent director. Joele noted JPMorgan Chase's success in framing its independent chair proposal as a referendum on the CEO himself. She explained that this is a good strategy if a CEO has high-profile contacts who will publicly endorse him or her. Joele explained that this strategy naturally works best for larger corporations with greater amounts of press coverage. She also noted that JPMorgan ran an intelligent, informed campaign with significant board engagement with shareholders.

At this point, Rich discussed another development from the JPMorgan contest regarding who is entitled to have access to the voting data for a Rule 14a-8 shareholder proposal. Broadridge stopped providing that information to the shareholder proponent and was subject to heavy criticism. It seems that Broadridge is not currently providing voting information to proponents unless they mail their own proxy card. As a result, there have been several recent shareholder proposals at companies such as Verizon requesting enhanced confidentiality of voting data. Implementation would make the vote tally and other details unavailable to management and the board until the annual meeting. It is unclear whether such proposals will gain traction, but this is an area worth watching.

The panel next examined proposals for proxy access. Proxy access is a regime by which a qualifying shareholder can nominate director candidates that will appear in the company's proxy statement and on its proxy card alongside the company's nominees. Proposals for proxy access can take several different forms, which vary according to the ownership and holding period thresholds required for shareholders to enjoy proxy access for nominees of a given percentage of the board. The "retail variety" typically includes low thresholds and results in an ISS recommendation against the proposal. The "Norwegian variety" consists of proposals from Norges Bank that feature a 1 percent ownership threshold, a one-year holding period and a 25 percent cap on board seats. ISS recommends in favor of these proposals, which averaged 34 percent of voting support in 2013. Finally, there is the "SEC variety," which is based on the vacated SEC proxy access rule. This category features a three-year holding period with a 3 percent threshold and a cap of 20-25 percent of board seats. This SEC variety of proxy access proposals has recently received majority support at companies such as Verizon, CenturyLink and Darden Restaurants.

Stephen expressed support for proxy access but noted that it may not always be appropriate if, for example, a company has cumulative voting. Abe noted that most investors support proxy access in some form and many that formerly supported very high thresholds are shifting to support the SEC variety of three years and 3 percent ownership.

Finally, the panel addressed the Timken Company's shareholder proposal that resulted in the company's announced plan to separate into two companies. Panelists disagreed about whether these types of proposals will occur more frequently, though all agreed that this development will not replace activists running proxy contests.

Responding to Activism

Next, the panel discussed how companies should prepare for shareholder activism and how they should react to an activist. Rich and Joele emphasized the importance of assembling a team at an early stage that can guide the company in preparation and in response to activism. This team should include corporate counsel, investment bankers, a public relations firm, proxy solicitors and a shareholder engagement or governance advisor.

Panelists stressed the need to engage early and often with shareholders. The first time a company meets an institutional shareholder should not be after an activist has emerged. Advisors can play a crucial role in helping a company craft its engagement plan to optimize relationships with shareholders. The company should communicate its strategic plan early to shareholders to avoid playing catch-up once an activist surfaces.

Once an activist approaches, he or she may request a meeting with management. Panelists agreed that it is important to take the meeting. The meeting sets a record of shareholder engagement, and it is an opportunity to learn more about who the company is dealing with. It is usually best to do more listening than talking. The advisory team can help prepare for the meeting.

As a situation involving an activist develops, a company should take the "high road" in responding to attacks. It also should maintain consistency of message and consult advisors when addressing activists' points. Throughout this process, it is helpful to maintain good relationships with the media. The company should conduct interviews around planned corporate events and other announcements that present "easy wins" for the company's public relations.

The panel concluded by taking questions from the audience in New York and over the web. Joele emphasized the need to take the "high road" in all responses to activists, noting that shareholders do not like it when companies are seen as getting "into the dirt." Everything must be approached in terms of what will win or lose shareholder votes. Stephen addressed a situation in which a management proposal for declassification is supported by shareholders but not by a supermajority threshold. While not speaking for all institutional investors, he said that he would like to see it proposed again.
