

Proxy Season 2016: A Look Back and A Look Ahead

Speakers

Bill Anderson, Senior Managing Director and Global Head of Activism/Raid Defense Business and Strategic Shareholder Advisory Practice, Evercore

Prior to joining Evercore, Bill Anderson led Goldman Sachs' top-ranked activism and raid defense for over 10 years. He pioneered the practice of activism defense and has advised over 200 companies facing activists or strategic raids. Anderson advises companies worldwide in connection with mergers and acquisitions, special committee situations, corporate governance issues, cross-border transactions, contested shareholder situations and preparing for hostile activity.

Bruce Goldfarb, President and CEO, Okapi Partners

Bruce Goldfarb works closely with a wide range of clients including corporations, mutual funds, activist investors and shareholder groups as well as private equity sponsors and hedge funds, in solicitation and investor response campaigns. He focuses on proxy solicitation strategy, execution for mergers and acquisitions, proxy fights and other extraordinary transactions.

Kai Liekefett, Partner, Head of Shareholder Activism Response Team, Vinson & Elkins

V&E has been ranked No. 1 by The Wall Street Journal/Fact Set and Thomson Reuters for activism defense in 2015, and Liekefett heads V&E's Shareholder Activism Response Team. Liekefett is a corporate partner with over 15 years of experience practicing law in New York, London, Germany, Hong Kong and Tokyo. He has extensive experience advising companies on proxy contests and other shareholder activism campaigns. Moreover, Liekefett represents companies and financial advisors in connection with public and private mergers & acquisitions, with a special focus on hostile M&A transactions.

Moderator

Greg Radner, Chief Marketing Officer, RANE

The 2016 proxy season has been extraordinary in many respects. To date, activists have waged over 220 reported shareholder activism campaigns and more than 110 proxy fights against corporate America. Institutional investors have actively challenged boards to think differently about strategy, risk, and board composition. Large asset managers have been more vocal about corporate governance and its impact on risk mitigation while calling for increased board accountability and transparency.

Despite these increased demands, investor support for directors and executive

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compensation programs remained high, with a record number of proxy access proposals and widening adoption in the market.

Three experts recently took part in a RANE/Vinson & Elkins webinar to examine the key takeaways and trends from the most recent proxy season as well as ways that companies can prepare for the next season. Highlights from the discussion follow:

Why Are Proxy Fights More Common Now?

- “Until about fifteen years ago,” noted Kai Liekefett, “investors who were not happy with a company would vote with their feet and sell the stock.” After the scandals of Enron and WorldCom, however, more shareholders have turned to activism to protect their investments.
- Bruce Goldfarb attributed the increasing willingness of investors to engage in activism to an increase in support from other investors. “Part of that change is from the volatility in markets, part because it’s not quite easy to do the Wall Street Walk – sell off your shares and leave – as it used to be,” he said.
- Ten years ago, shareholder activism meant hedge funds putting companies under pressure when they thought they were being mismanaged. Now, however, more traditional, long-term investors are turning to activism. Since 2014, Liekefett pointed out, first-time or occasional activists have led 41 percent of all activist campaigns.
- “Even in the last few years, the dynamic among shareholders has changed,” argued Bill Anderson. “And a lot of the change has been driven by the fact that active funds have substantially underperformed index funds for the last five years.”
- In a crowded asset management environment, Goldfarb noted, money managers increasingly feel they have to demonstrate their active roles overseeing clients’ funds by voicing any serious concerns they might have about a company’s performance or management.
- “We’re not always clear as to whether or not a disgruntled shareholder will remain passive or is willing to go to a proxy fight,” said Liekefett, “which makes negotiations significantly more uncertain with those investors.”

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The Activists’ Top Targets

- “Any company that has underperformed is a potential target for a proxy campaign in the current environment,” advised Goldfarb. “Everybody needs to know their shareholders, needs to be able to articulate their message, and needs to have a fulsome engagement program.” He added that the market volatility predicted in the next year creates the potential for a growing number of new underperformers.
- “There are two hundred activist hedge funds with two hundred billion dollars in capital looking for targets,” said Liekefett. “You do the math - almost every company is a potential target.” Many small companies believe that they will not be on activists’ radars, without realizing that 70 percent of all proxy fights are against companies with a market cap under one billion dollars. “You don’t hear about those fights on the news,” he added, “so small companies don’t realize the risk is real and exponentially larger at their company than at a big one.”
- Anderson believes that financial institutions will be a target for activist investors in

the future. "There's that 'let's break up the financial institutions' sentiment," he said," and it's harder to make money there now given the regulatory overlay."

- Liekefett points out that energy is seeing a comeback in activism. "Several celebrity activists have been going quietly after oil and gas companies, including Starboard, Elliott and ValueAct," he noted. "There's the perception that the worst is over in the energy industry. Many activists believe that there is now significantly more upside potential than downside risk in the oil and gas industry."

Communicating with Shareholders

- All experts agreed that communicating effectively with shareholders is key to avoid becoming the target of a proxy battle. "Your three focuses as a company are customers, employees, and shareholders," said Anderson. "You need to reach out, to communicate to shareholders that you have the right board for the company's strategy, and you need to sell that before an activist shows up."
- Goldfarb also stressed the importance of shareholder outreach. "The ability for individuals to vote has increased," he said, "and we've actually seen a number of situations in the past year where it was retail shareholders who made the difference in having management win campaigns that one might have expected would be a victory for activists."
- "Ten years ago, investor relations was a stop for junior finance people on the way up the ladder," said Anderson. "Activists have elevated that function, but it has also been elevated by boards who want more information from their shareholders."
- "It's rare for me to defend a company in a proxy battle where the activist has it all wrong," said Liekefett. "What we're trying to do is take off the table as many topics as possible, and that includes many topics for which the root of the problem is a communication issue. "We try to make the activist decide that this isn't the company they want to go after next proxy season. An activist can only wage two or three fights a season, so they're going to choose the two or three they're most likely to win."
- Anderson noted that getting the right message out to shareholders can be difficult. "Often active and passive funds are looking for different messages," he said. "It can be like communicating in a public election – you have to get a message out that resonates with both Republicans and Democrats."
- "We've seen that, in a market where there's a rising tide of information, activist investor groups have had to raise their game," noted Goldfarb. "That means a deeper dive into understanding companies and the underpinnings of business."

The Public Relations Angle

- "You can call me a cynic," said Liekefett, "but I always saw the PR aspect of activism essentially as a legal form of blackmail, in particular in small- and mid-cap situations. Essentially, often the activist is saying, 'you either sell the company or I'm going to embarrass your management and directors on every level of life.'"
- Anderson noted that companies have become much more sophisticated on their responses to activism. "The battle is a bit asymmetrical, as activists can deliver surprise public challenges that often require prompt responses. But companies can be slow to act, as they need to go through rigorous fact-checking processes and Reg FD checks before delivering those responses. As a result, management

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teams are now arraying facts and potential responses, just in case a public event occurs. However, companies are not quite yet in the world of Tweeting responses."

- "We live in a world right now where the velocity of information is quite fast, where investors take in news and information on a round-the-clock cycle," said Goldfarb. He noted that activists have come to recognize that using PR is in their benefit. However, companies also have the option to use PR for their advantage.

The SEC, Universal Proxy Cards, and Disclosure

- The SEC appears to still be looking at whether or not universal proxy cards should be implemented in proxy fights. "There are a lot of pitfalls," said Goldfarb, "and I can see advantages to both companies and activists in any given situation. What's certainly clear is that each side would want to know that there are rules of the road for doing these proxy fights with a universal card. There needs to be clarity on the issue."
- "The rules around disclosure were written before there were computers and haven't been revamped much," said Anderson. "A lot of the big changes happened ten years ago, and they've made activism much easier."
- "The lack of progress in Washington on all of these topics is depressing," said Liekefett. "Many of these topics should have been dealt with years ago. Even Brazil has a more sophisticated disclosure system than we do."

Shareholder Proposals

- According to Liekefett, shareholder proposals tend to focus on governance, environment, and political/social issues. Proposals on corporate governance are the most common, and will likely become more frequent. "Often," he added, "they're just the first shot from unhappy investors and the company subsequently becomes a target of an activist campaign."
- Social and environmental issues rarely reach a majority of support. "That doesn't mean companies should take these proposals lightly," Liekefett noted. "When shareholders are asking questions about stance on environmental sustainability, obviously this is a tremendous distraction for the company – companies should proactively try to address these issues."
- Goldfarb noted seeing ten situations this year in which a case involving environmental or social issues won majority shareholder support. "The average support for these resolutions climbed a percentage point," he said. "Companies should be thinking about these issues, particularly if they're in industries where environmental impact can matter. We're seeing a demographic shift, and some investors are feeling the burn."

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