

# GIBSON DUNN

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## Shareholder Engagement and Activism:

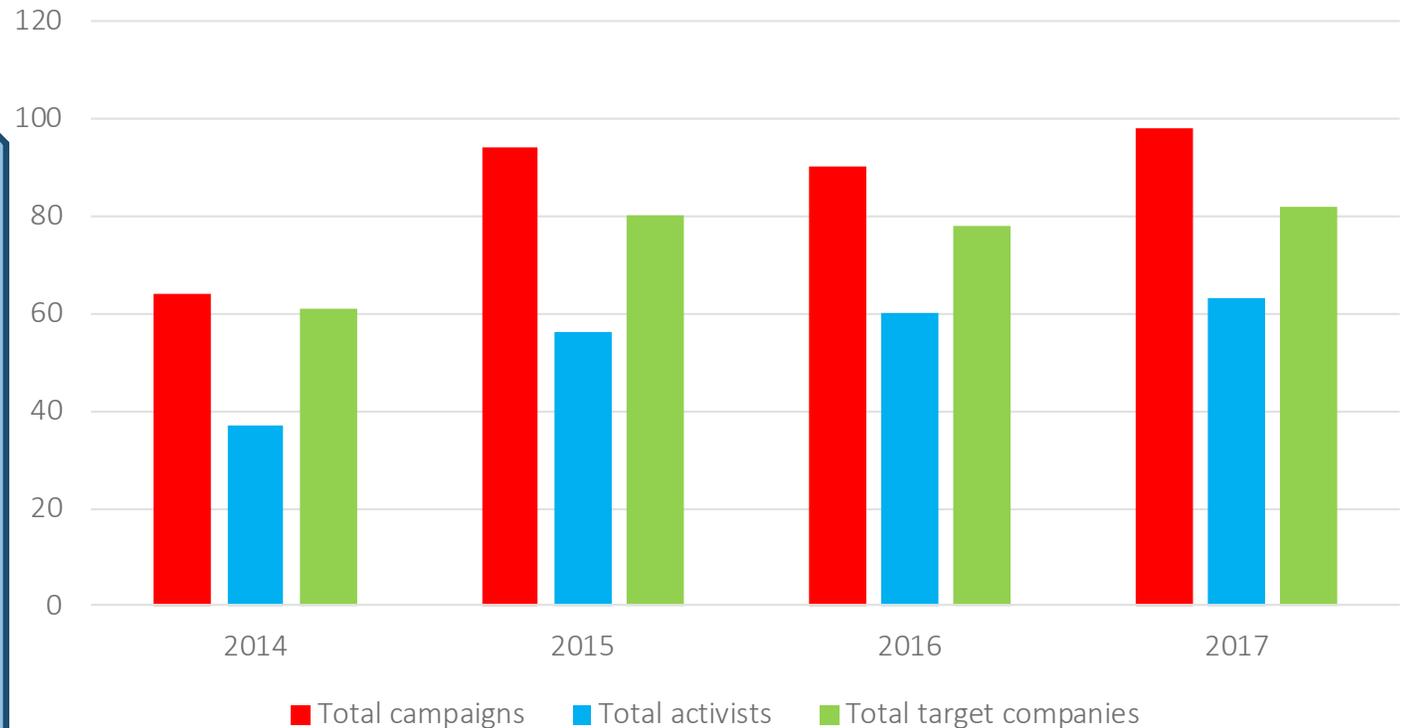
Preparing for the 2018 Proxy Season

February 28, 2018

# Activism is the New Normal

## Activist Campaigns, Investors & Target Companies\*

Based on the activist campaigns studied for Gibson Dunn's Activism Update\*, activism continued to increase from 2014 to 2015 and remained at a high level in 2016, despite a difficult market backdrop. In 2017, the pace of activism picked up yet again.



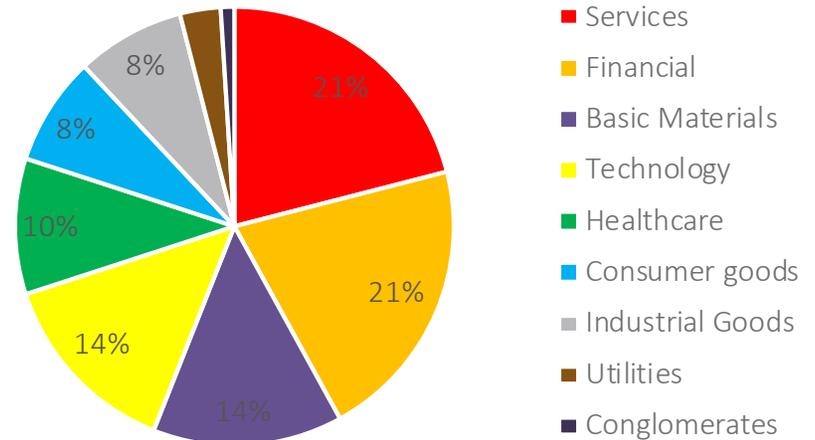
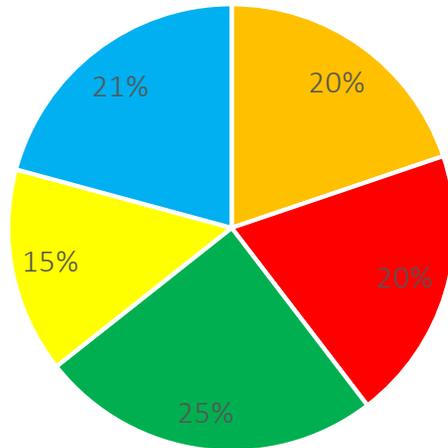
\* Includes activist campaigns involving NYSE- and NASDAQ-listed companies with market caps greater than \$1bn in each calendar year.

# Activism is the New Normal

## No Company is Immune from Activism

- In 2017, activist investments were spread across all sectors, ranging from 8% in industrial goods to 21% in services. Only conglomerates (1%) and utilities (3%) (a heavily regulated sector) saw very limited numbers of activist investments.

- Nano-Cap
- Micro-Cap
- Small-Cap
- Mid-Cap
- Large-Cap



- In 2017, market capitalization also had little effect on the willingness of activists to invest in a company. Though mid- and large-cap companies, such as Proctor & Gamble, made up only approximately 36% of companies invested in by activists, the partial imbalance is in part a result of there being fewer such companies, not a result of activists being unwilling to invest in larger target companies.

# Preparing for Shareholder Activism

## Board review

- Periodic review of activism preparedness plan, defense profile, long-term plan and state of activism
- Be your own activist

## Identify and coordinate response team

- Create small team including management, financial advisor, lawyer, public relations specialist and proxy solicitor, when risk is substantial

## Maintain dialogue with shareholders and media

- Important that key shareholders are not hearing from the Company for the first time only after an activist has gone public or a takeover offer has been made

## Monitor for signs of activism

- Contact with investor relations, stock activity, analyst reports, SEC filings, press commentary, investor forums, letters to limited partners

# The Importance of Institutional Investors in Activism

- There has been a **significant increase in the past year** by institutional investors in setting forth their views on a variety of issues relating to board composition, including director tenure, board refreshment, board evaluations, board diversity, overboarding, shareholder engagement, and environmental and social issues.
- Many **governance activists** use approaches that often include criticism of boards and senior management, with assertions that overlap with institutional investors' concerns.
- These **governance activists' strategies** often include submitting shareholder proposals, enlisting director nominees, engaging with institutional shareholders to build support, and litigation to access board minutes to gain insider knowledge of board relationships.
- To better **prepare for shareholder activism**, it is critical to develop a shareholder engagement strategy that properly addresses areas of focus by activist investors.
- Companies **should be also aware of** voting guidelines of proxy advisory firms, such as ISS and Glass Lewis, as they affect voting decisions of shareholders who do not develop their own voting guidelines.

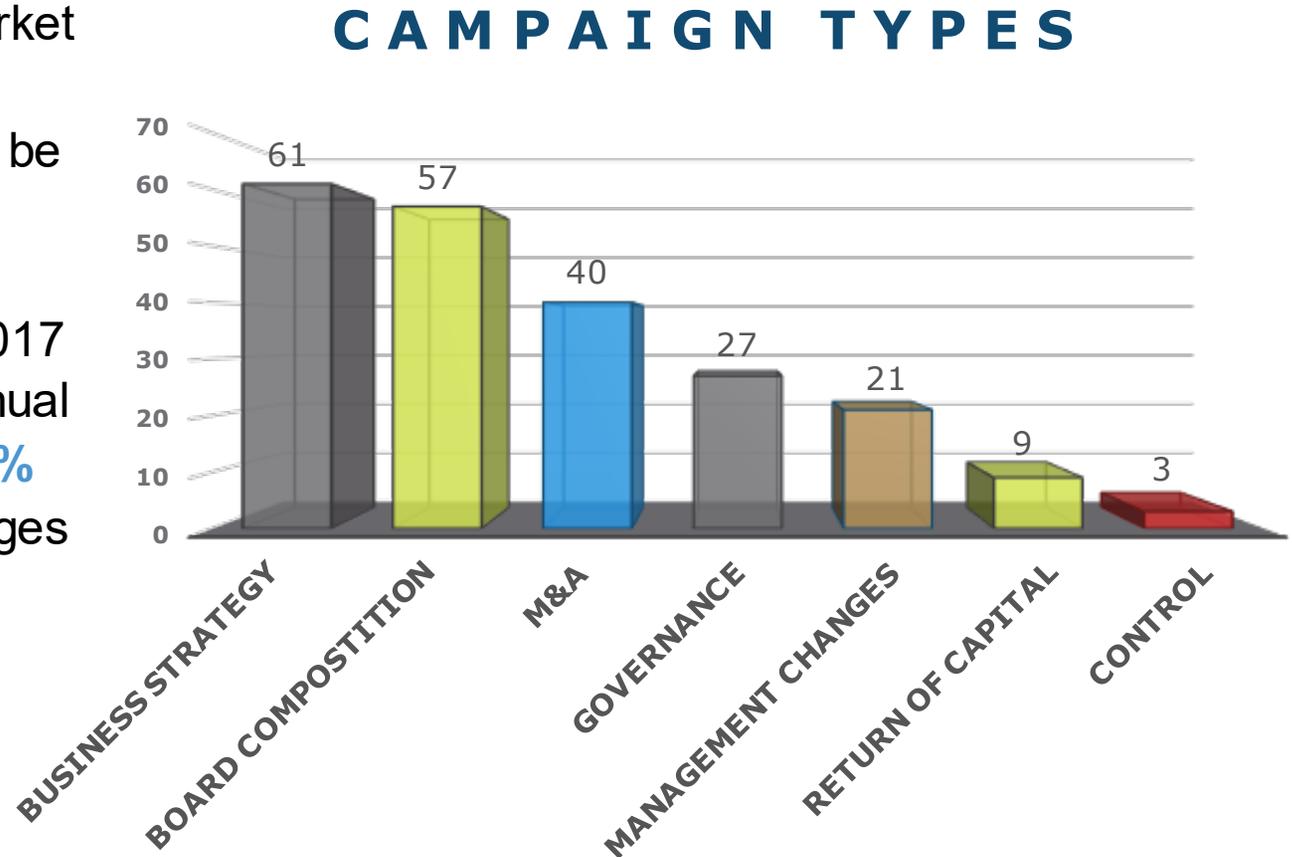
# Growing Involvement of Institutional Investors

- Large index funds and other institutional shareholders have become increasingly vocal on governance and corporate strategy issues and enhanced their attention to their voting policies.
- Union and state and local government pension funds are successfully pressing a number of governance and corporate strategy issues.
  - Buoyed by the success of its 2015 initiative to have companies adopt proxy access, the New York City Comptroller sent letters to the boards of 151 companies in September 2017 asking them to disclose a director qualifications matrix “identifying each director’s most relevant skills, experience and attributes” as well as gender and race/ethnicity. In follow-up discussions, the Comptroller’s office has encouraged companies to pursue board refreshment.

*“[I]f we collectively are going to focus on benefitting shareholders instead of wasting time and money in proxy fights - then engagement needs to be a year round conversation about improving long-term value.” Larry Fink, Chairman and CEO, BlackRock, Inc.*

# Areas of Focus

- Regardless of sector or market capitalization, board representation continues to be one of the primary goals of activist investors. Of the **98 campaigns surveyed** in 2017 by Gibson Dunn's semi-annual Activism Update, **about 60%** involved demands for changes in board composition.



# Areas of Focus and Institutional Investors' Views

- **Director tenure and refreshment:**

- State Street may vote against directors when overall average board tenure is excessive and/or when individual director tenure is excessive.

- **Board evaluation:**

- State Street believes board evaluations need to be enhanced to achieve “the desired result of strengthening of the board’s composition, its procedures and practices.”

- **Board diversity:**

- BlackRock expects to see at least two women directors on every board, even though neither the SEC nor the proxy advisory firms have a requirement.

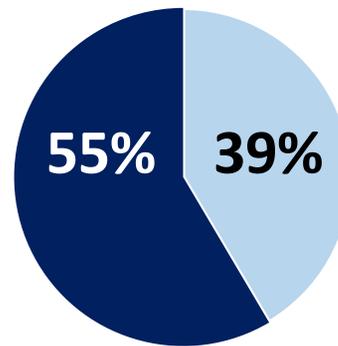
- **Overboarding:**

- BlackRock has more stringent policy than proxy advisory firms, limiting the maximum number of outside public boards on which a director may serve to 3, and in case of a director who is also a public company CEO, to 1.

# Shareholder Engagement is on the Rise

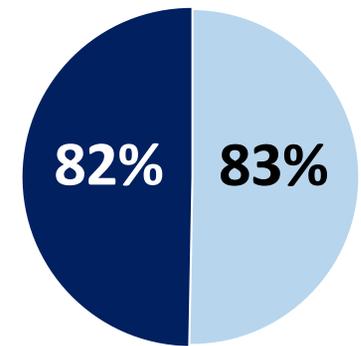
- Interactions between shareholders and boards continue to increase, and many companies are proactively reaching out to large shareholders, also in light of proxy statement disclosure on shareholder engagement efforts.

- According to the 2017 Spencer Stuart Board Index survey, **55%** of respondents (vs. **39%** in 2016) said they were contacted formally by institutional investors and/or largest shareholders specifically regarding governance-related topics.



■ 2016 ■ 2017

- **82%** of respondents said their management or the board reached out to the company's large shareholders (vs. **83%** in 2016).



■ 2016 ■ 2017

- Develop an engagement strategy, considering:
  - Shareholders: knowing shareholder base and who to contact
  - Timing: checking in with investors early and follow up after proxy statement is filed, reserving proxy season engagement for urgent issues on voting items
  - Agenda: agreeing on consistent message on each topic and talking points
  - Team: including right personnel (governance, legal, compensation, ESG, etc.)

# Litigation Considerations

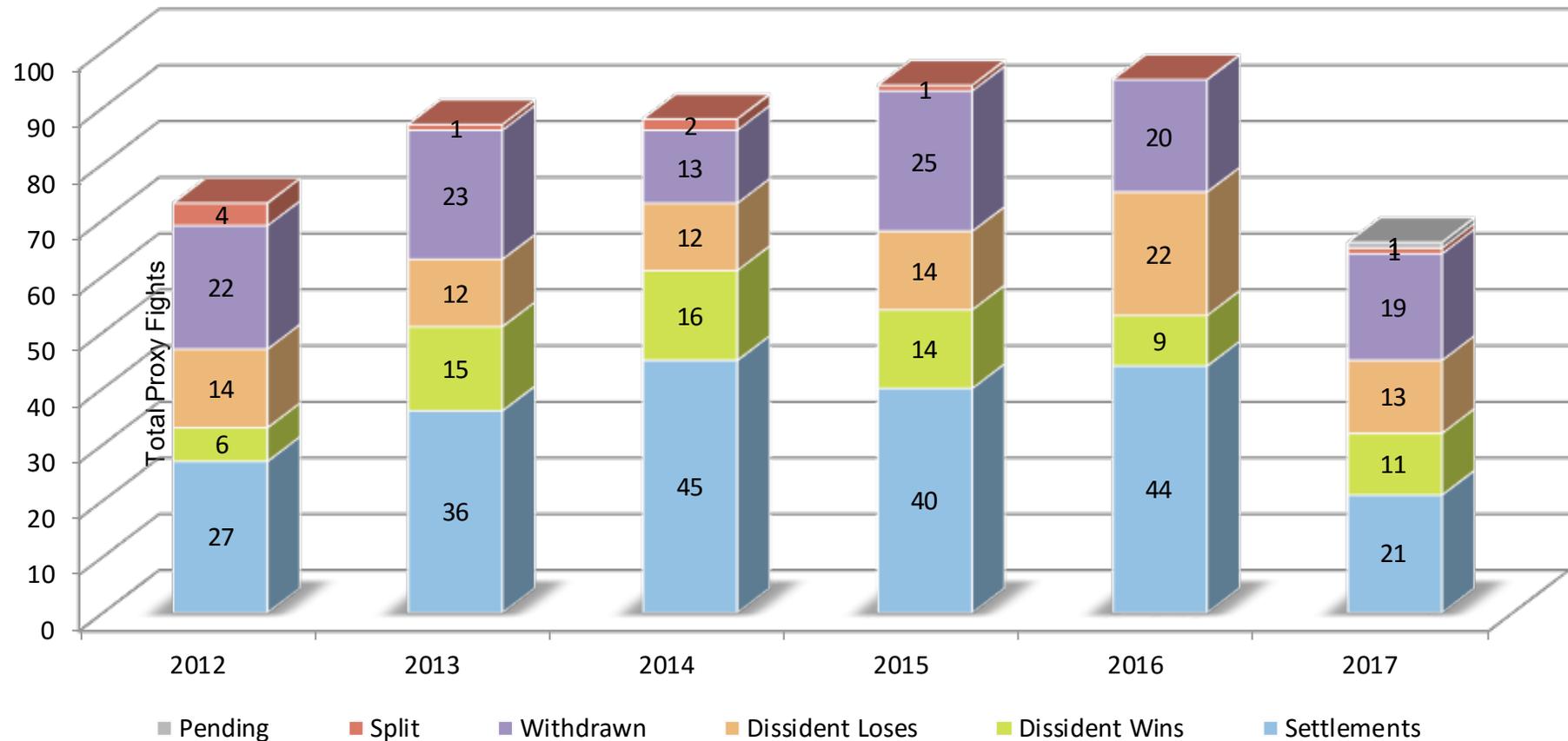
- Boards must carefully consider **process** for addressing all aspects of interactions – from initial contact, consideration of proposals from activists, proxy contests, and litigation
  - Directors must act at all times in best interest of all stockholders
  - Cannot put own interests ahead of stockholders
  - All actions are likely to be heavily scrutinized in proxy contest and/or litigation.
    - Minutes, emails, text messages
- Retention of experienced advisors to guide process critical

# Litigation Considerations

- Increase in books and records demands
  - Applicable state law matters
- Litigation brought by activists, common stockholders, and companies / Boards
- Litigation themes
  - Standard of review can vary – business judgement, enhanced scrutiny
  - Disclosure issues paramount
  - Rigorous process, and documentation of process, important
  - Even settlement negotiations must follow good process and can be subject to challenge

# Proxy Fights and Settlements

Settlements Have Been the Most Common Outcome in Proxy Fights



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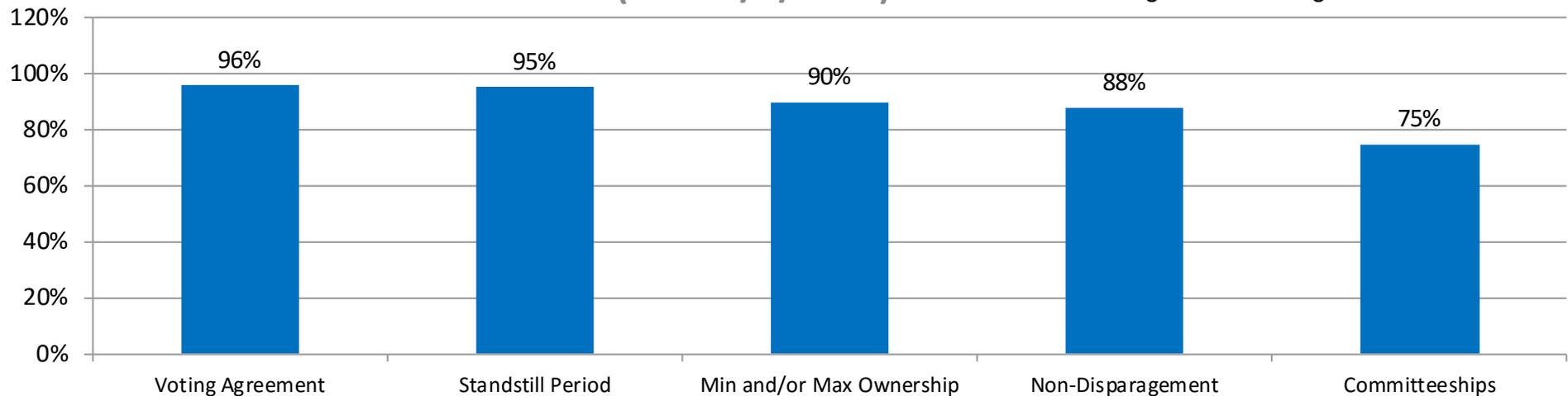
Based on the 80 publicly filed settlement agreements studied by Gibson Dunn's Activism Update since the beginning of 2014, an average of 2.1 board seats per agreement have been granted and the inclusion of certain key terms (below) has become the norm.

### 2014-2017 Board Representation Analysis

Category	Average
Board Seats Granted	2.1
Total Board Size*	10.9
Percent of Board*	18.4%

\*Following settlement agreement

### Common Settlement Provisions (since 1/1/2014)



Source: Activism Update

# Panelists



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