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Lessons from the 2013 Proxy Season

1. Shareholder activism is growing at an increasing rate. No company is too big to become the target of an activist, and even companies with sterling corporate governance practices and positive share price performance, including outperformance of peers, may be targeted.

2. "Activist Hedge Fund" has become an asset class in which institutional investors are making substantial investments. In addition, even where institutional investors are not themselves limited partners in the activist hedge fund, several now maintain open and regular lines of communication with activists, including sharing potential "hit lists" of possible targets.

3. Major investment banks, law firms, proxy solicitors, and public relations advisors are representing activists.

4. ISS and Glass Lewis continue to play a major role in proxy solicitations and favor activists over management. They see no problem in supporting a short slate of an activist's director candidates for the purpose of "shaking things up," regardless of the merits of the activist's proposals, and they ignore legitimate concerns over creating dysfunction and paralysis in the boardroom. It is a mistake to assume that they understand the basic business and long-term business strategy of a company attacked by an activist. It is necessary to make a sophisticated presentation of the company's finances and business to have any prospect that they will reject the activist's argument and support the company's.

5. Major institutional investors, including BlackRock, Fidelity, State Street and Vanguard have established significant proxy departments that make decisions independent of ISS and GL and warrant careful attention. It is important for a company to know the voting policies and guidelines of its major investors, who the key decision-makers and point-persons are and how best to reach them. It is possible to mount a strong defense against an activist attack that is supported by ISS and GL and gain the support of the major institutional shareholders.

6. Active participation, including visits to ISS and major shareholders, by the lead director and the other independent directors is critical in a proxy contest.

7. The failure of a company to maintain regular contact with its institutional shareholders will result in a very significant disadvantage in a contested proxy solicitation. Early outreach can prevent institutional shareholders from mistakenly concluding that supporting activism is the only path for successful engagement with a company.

8. The investor relations officer is critical in a proxy solicitation. The regard in which the IR officer is held by the institutional shareholders has been determinative in a number of proxy solicitations. Candid IR assessment of shareholder sentiment should be appropriately communicated to senior management, with periodic briefings provided to the Board.

9. Relationships with sell-side analysts are important and should be proactively developed. A company should be on the lookout for new suggestions or ideas floated by the sell-side community. If analysts are making errors, the company should correct them and educate them about the business; ideas suggested by analysts, even ill-advised ones, can generate momentum and inspire activist approaches.

10. Media outlets tend to favor the "shareholder rights" mantra of activists. A proactive public relations campaign is important in seeking a level playing field.

11. A company should not wait until it is involved in a proxy solicitation to have its institutional shareholders meet its independent directors. A disciplined, thoughtful program for periodic meetings is advisable.

12. Scrutiny of board composition is increasing, and boards should self-assess regularly. Institutional investors frequently question the "independence" of directors who are older than 75 or who have served for more than 10 years. In addition, they may discount the independence of directors solely because they have been nominated by the company as compared to an activist's nominees. In some situations consultation with major shareholders about potential nominees may be important.

13. Periodically, and at least shortly after each annual meeting, a company should review its portfolio, governance and preparation for defense against an activist attack in the light of potential activist perspectives and consider appropriate adjustments. Experienced advice is critical ISS and GL and institutional investors discount strategic and governance changes that are initiated after an activist has surfaced, even if there is evidence that the changes were previously "in-the-works."

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