

Preparing for Shareholder Activism in the 2010 Proxy Season

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Overview

- Shareholder activism and the current environment
- 2009 shareholder proposal trends and no-action letters
- Popular proposals to expect in the upcoming 2010 proxy season
- Company actions to address shareholder proposals
- Proxy advisory firms' latest voting recommendation policies
- Traps for the unwary under amended NYSE Rule 452
- Q&A

The Current Environment

- Legislative and regulatory activity
- Proxy access pending
- New corporate governance disclosure requirements
- Notice and access and importance of the retail vote
- Rule 452 and broker discretionary authority

Review of 2009 Shareholder Proposal Trends and SEC Staff No-Action Letter Interpretations

- Number of shareholder proposals submitted:*
- 2009: 1,147
- 2008: 1,138
- Number of no-action letters requested/issued:
- 2009: 336
- 2008: 404
- Shareholder proposals receiving strong support in 2009 (percentage is based on average votes cast):
- Remove supermajority vote requirements (71.6%)
- Declassify board of directors (65.8%)
- Require majority vote to elect directors in uncontested elections (59.1%)
- Allow 10% of outstanding shares to call special meetings (51.1%)
- Advisory vote on executive compensation (45.7%)
- Independent board chair (36.7%)

*Certain statistics throughout this presentation are based on information compiled by RiskMetrics Group Inc.

Reported as of January 31, 2010

Review of 2009 – Continued

- Notable 2009 no-action requests/letters:
 - Say on pay shareholder proposals and TARP
 - Proxy reimbursement
 - Reincorporate in North Dakota
 - Special meetings
 - Alter ego
- Other 2009 trends:
 - Increase in number of, and support for, social issue shareholder proposals
 - SEC staff narrowing the scope of the ordinary business exclusion

2010 Shareholder Proposals: Executive Compensation

- Say on Pay:
 - 82 shareholder proposals submitted in 2009 and supported by an average of 45.7% of votes cast
 - Recent developments: pending legislation, biennial/triennial vs. annual say on pay votes
- Executive death benefits:
 - Seeks a shareholder vote on payments to senior executives' estates after their death
 - 13 shareholder proposals submitted in 2009 and supported by an average of 39.6% of votes cast
- Anti-tax gross-up policies:
 - Requests a policy of not providing executives with any tax gross-up payments (*i.e.*, reimbursements to cover executives' tax liability) that are not available to other managers
 - Two shareholder proposals submitted in 2009 and supported by an average of 50.2% of votes cast
 - RMG considers tax gross ups to be a “poor pay practice”; potential for withhold or against vote recommendation

2010 Shareholder Proposals: Executive Compensation – Continued

- Retention period for stock awards:
 - Proposals call for executives to retain stock acquired as a result of equity awards until two years past retirement
 - 17 shareholder proposals submitted in 2009 and supported by an average of 24.6% of votes cast
- Establish bonus banks:
 - Proposals ask companies to not pay out short-term bonuses until corporate performance on which bonuses were based has been sustained for a period of time
 - Five shareholder proposals submitted in 2009 and supported by an average of 26.6% of votes cast

2010 Shareholder Proposals: Corporate Governance – Risk Management

- Risk management:
 - Historically excluded by the SEC staff as ordinary business because relates to “evaluation of risk”
 - Examples of risk management proposals that have been excluded include proposals requesting:
 - a report on how the company is assessing the impact of climate change on the company;
 - that the company disclose collateral and other credit risk management policy for off-balance sheet liabilities and exposure in certain areas;
 - a report on the company’s potential financial exposure as a result of the mortgage securities crisis; and
 - that the board establish a compliance committee to review the company’s regulatory, litigation and compliance risks with respect to its mortgage lending operations
 - Shareholder proponents have expressed objections to the SEC staff to the excludability of these shareholder proposals on ordinary business grounds
 - SEC staff recently changed its approach re: excludability of these shareholder proposals, See Staff Legal Bulletin No. 14E (Oct. 27, 2009)

2010 Shareholder Proposals: Corporate Governance – Special Meetings

- Prohibiting shareholders from calling a special meeting is a standard takeover defense
- Shareholders began submitting special meeting shareholder proposals in 2007
- Special meeting shareholder proposals request that companies amend bylaws to give holders of a specified percentage of stock (typically 10%) the power to call a special meeting
- 61 shareholder proposals submitted in 2009 and supported by an average of 51.1% of votes cast (compared to 46.6% in 2008)
- 29 proposals won majority support (compared to 10 in 2008)
- Special meeting shareholder proposals have passed even at companies that already allow shareholders to call a special meeting
- SEC has permitted companies to exclude special meeting shareholder proposals where company indicates that it will present a conflicting proposal (*e.g.* one with a different threshold)

2010 Shareholder Proposals: Corporate Governance – Independent Chair

- Request either an independent chair or separation of CEO/chair positions:
 - 40 shareholder proposals submitted in 2009
 - supported by an average of 36.9% of votes cast (compared to 29.3% in 2008)
 - five proposals won majority support (including a binding proposal at Bank of America Corp., receiving 50.3% of the vote)
 - companies have negotiated withdrawal of proposal based on revisions to their bylaws and corporate governance principles

2010 Shareholder Proposals: Corporate Governance – Majority Voting

- 2/3^{rds} of the S&P 500 firms have either a resignation policy or have responded to activists' demands to adopt a full majority voting bylaw
- Majority Voting is less common at smaller firms; 57% of S&P 1500 firms & 82% of small-cap firms still have plurality voting without resignation provisions
- Majority voting shareholder proposals are being submitted to mid- and small-cap companies
 - 58 proposals submitted in 2009
 - supported by an average of 59.1% of votes cast (compared to 51.2% in 2008)
 - 32 won majority support (compared to 11 in 2008)
- Before adopting a majority voting standard, companies should consider the impact of the recent amendment to NYSE Rule 452

2010 Shareholder Proposals: Corporate Governance – Succession Planning

- Labor groups filed succession planning shareholder proposals at several companies in 2008 and 2009
- These proposals generally have been excludable on ordinary business grounds
- The Laborers' International Union of North America (LIUNA) has submitted succession proposals to several companies in the 2010 proxy season
- The SEC Staff changed its approach re: excludability of these shareholder proposals, See Staff Legal Bulletin 14E (Oct. 27, 2009)
- Companies have negotiated withdrawal of proposal based on commitment to provide more fulsome disclosure about their succession planning process

2010 Shareholder Proposals: Corporate Governance – Declassification

- Board declassification:
 - proponents are submitting these proposals and focusing on small- and mid-cap companies
 - 89 shareholder proposals submitted in 2009 and supported by an average of 65.8% of votes cast (compared to 65.1% in 2008)
 - companies generally cannot exclude these proposals unless “substantially implemented”
 - typically can substantially implement declassification shareholder proposal even if “phase-out” classified board
 - Over 60% of S&P companies now have annually elected boards

2010 Shareholder Proposals: Social Issues

- Climate change and renewable energy:
 - 34 shareholder proposals submitted in 2009 and supported by an average of 20.3% of votes cast
 - traditionally submitted to companies in energy and construction industries
- Political contributions:
 - 31 shareholder proposals submitted in 2009 and supported by an average of 29.7% of votes cast
 - these shareholder proposals often are withdrawn following negotiation
- Health care reform principles:
 - 23 shareholder proposals submitted in 2009 and supported by an average of 5.3% of votes cast
 - traditionally submitted by the AFL-CIO and religious groups
 - these shareholder proposals often were withdrawn following negotiation

Company Actions to Address Shareholder Proposals

- In the current environment, consider whether to take action in advance of receiving shareholder proposals -- importance of shareholder engagement
- After the company receives a shareholder proposal:
 - negotiate with the proponent
 - may be able to substantially implement (Rule 14a-8(i)(10))
 - company may submit a conflicting proposal (Rule 14a-8(i)(9)) -- need not be “identical in scope or focus,” but must present conflicting decisions for shareholders

Actions to Address Shareholder Proposals – Continued

- If the company includes the shareholder proposal in its proxy statement:
 - determine if there are actions that can be taken to convince proxy advisory firms to recommend votes against the proposal
 - some shareholder proponents may engage in more active solicitations in favor of their proposals
 - determine how many shareholders follow voting guidelines of RiskMetrics Group or Glass Lewis & Co.
 - determine likely level of shareholder support
 - discuss the proposal with shareholders sending our fight letters

Proxy Advisory Firms

Many institutional investors use third-party proxy advisory firms to provide them with vote recommendations on shareholder meeting proposals to be voted on

RiskMetrics Group – RMG (formerly ISS)

Largest & most influential advisory firm

- Can directly influence vote of 25% or more of shares outstanding
- Close to 2,000 issuer clients & covers 38,000 meetings in over 100 markets
- Most institutions review the RiskMetrics research in some capacity
- RMG's policy is transparent in most cases
- Are willing to speak with corporate issuers, in some instances
- Provides paid services to issuers – criticism over perceived conflict

Proxy Advisory Firms

Glass Lewis & Co. -- *Largest competitor to RiskMetrics Group*

- Will not communicate directly with issuers, but in select high-profile and controversial issues will sponsor ProxyTalk
- Less transparent & less influential on voting than RiskMetrics
- Does not offer services to issuers

PROXY Governance, Inc. -- *The “third” proxy advisory firm; Very little direct influence, but can be used for Public Relations purposes*

- Will open to communicate with parties during contested matters
- Does not offer services to Issuers

Egan Jones Proxy Services -- *Historically has been in the credit ratings arena and is now a direct competitor to the above firms releasing recommendation reports*

Advisory Firms' Latest Voting Policies

- **RiskMetrics**
 - Effective for shareholder meetings after Feb. 1, 2010
 - Poison pills not welcome
 - applies to pills adopted or renewed after Nov. 19, 2009
 - long-term vs. short-term pills
 - classified vs. de-staggered boards
 - Increases in stock authorization
 - Proprietary model
 - Look back at uses over past 3 years
 - Focus on "enhanced narrative" in proxy statement
 - Compensation
 - Shareholder value transfer and burn rate tests
 - shift back to 200-day stock price and volatility test
 - Executive compensation evaluation (ECE)
 - pay-for-performance
 - poor pay practices
 - votes on MSOP (management proposals for "say-on-pay")

Advisory Firms' Latest Voting Policies - Continued

- **Glass Lewis**
 - Now providing an overall evaluation (for companies in the S&P 500) of the compensation policies and procedures as outlined in the CD&A, with ratings of good, fair or poor
 - Formal policy for management-sponsored Advisory Votes on Executive Compensation.
 - If a company receives an F grade in pay-for-performance and also provides shareholders with a Say-on-Pay vote, the recommendation will be to only vote against the Say-on-Pay proposal. Two successive F grades the vote recommendation will be against the members of the compensation committee and against the Say-on-Pay proposal
 - Raised against-vote-threshold from 25% to 50% regarding the past level of shareholder discontent, resulting in against/withhold on nominating committee chair

Background of NYSE Rule 452

- NYSE Rule 452, also referred to as the 10 Day Rule, provides brokers with discretionary voting authority, that is the ability to vote uninstructed shares (*i.e.* where a shareholder did not vote its proxy)
 - helps in establishing a quorum at shareholder meetings
- NYSE Rule 452 applies to the brokerage firms that are members of the NYSE and their ability to vote on behalf of their customers, regardless of whether the company is an NYSE listed issuer
 - applies to votes on issuers listed on all U.S. exchanges

Who will/will not be Impacted?

- Retail voting through custodian brokers will be impacted
- Not institutional investors
- Not registered stockholders

Rule 452: Routine vs. Non-Routine Proposals

There are 20 instances/exceptions where proposals may be deemed Non-Routine according to Rule 452: Giving Proxies by Member Organizations

Examples of Routine Proposals:

- Ratification of auditors
- Increase in authorized common stock (not tied to merger, etc.)
- Stock splits

Examples of Non-Routine Proposals:

- Uncontested Director Elections (as of January 1, 2010)
- Approve/Amend a Stock Plan
- Increase Authorized Preferred Stock
- Approval of Merger or Reincorporation
- Shareholder Sponsored Proposal (*limited exceptions*)
- Late Mailing!

Vote Response Rates

Retail Holders - generally apathetic towards the voting process

- Under traditional mailing options, historical voting data indicates approximately 25% to 35% of the shares will be returned absent any proactive solicitation strategies
- Very supportive of most management sponsored proposals, however stock performance, share value, and media attention can have an impact!
- Notice & Access will yield an even lower response rate approximately 14%

Registered Holders - slightly more responsive than retail investors

- We estimate 40% of the non-affiliated registered holder generally vote without direct solicitation efforts

Institutional Holders – fiduciary responsibility to vote

- Generally see 80% to 85% response rates
- Inability to vote shares out on loan
- May not vote shares that are sold after Record Date
- Do not always have voting authority over the shares they manage
- Foreign institutions rarely vote

Assessing The Impact of Amended Rule 452

Which Companies May Be at Risk?

- Small to Mid Cap Companies who have mid to high levels of retail ownership
- The change will impact NASDAQ companies more than NYSE Companies
 - NYSE Companies tend to have higher institutional ownership
 - Major difference in how Rule 452's amendments will impact large vs. small companies
 - Utility companies
 - Mature companies with many retail holders

Issuers with sizeable retail holdings will need to thoughtfully analyze impact of this change well in advance of their annual meetings and have a plan in place to ensure a successful director re-election process

Notice & Access: Electronic Delivery of Proxy Materials

Lower costs for printing services

- Same for activists, but not used often to launch contested solicitations
- Issuer Adopting Notice & Access Up:
 - 653 issuers adopted (7/01/07 – 6/30/08)
 - 1,363 issuers adopted (7/01/08 – 6/30/09)
- Retail voting down:
 - Shares declined by approx. 50% from 34% to 17%
 - Shares declined further by almost 30% from 17% to 12%

Alternate Options for Issuers to Consider:

- Consider modifying mailing options *
- Stratified Notice & Access:
 - Holders of 1,000 shares & up = USPS 1st class Mail
 - Holders of 999 shares & below = Standard A (formerly 3rd Class Bulk)

** The proxy solicitation advisor can prepare mailing recommendations*

The New Balance of Voting Power: Identifying Street Name Holders

Companies do not have access to identity of street name holders, except:

- Public filings (primarily 13F, 13G, 13D)
 - Many hedge funds do not file disclosing their ownership
- Non Objecting Beneficial Owner (NOBO) List
 - A NOBO listing provides the name, address and number of shares held by owners who have given their consent to allow this information to be disclosed
 - Very few institutional accounts and hedge funds show up on NOBO list
 - NOBO list generally reveals 40% to 60% for retail holders

A LARGE NUMBER OF COMPANIES DO NOT HAVE DIRECT ACCESS TO THE MAJORITY OF THEIR SHAREHOLDERS

“Just Vote No” Campaigns

“Vote No Campaigns” and other shareholder activism targeted to boards and individual directors may increase due to activists seizing the opportunity to pressure companies that have large retail ownership.

These companies will have a low vote response, and become easier targets for activists.

Case Study: Washington Mutual’s 2008 Meeting Vote Results. Vote No campaign by CtW (Change to Win)

Director(s)*	With Broker Voting		Projected Without Broker Voting	
	% Cast FOR	% Cast AGAINST	% Cast FOR	% Cast AGAINST
Stephen Frank	62.55%	38.86%	37.22%	38.86%
Charles Lillis	59.33%	40.67%	33.99%	40.67%
Margaret McQuade	60.99%	39.01%	35.66%	39.01%
James Stever	57.81%	42.19%	32.47%	42.19%

Based on Record Date shares outstanding and 179,722,208 shares voted by brokers

**Director nominee Mary Pugh resigned.*

Institutional Withhold/Against Voting on Directors

- Issue: The loss of broker voting on directors will further result in:
 - Amplified voting impact by institutional investors and hedge funds
 - Greater level of influence by proxy advisory firms on the voting process
- Proxy Governance recently reported significantly higher numbers:
 - “Despite fewer organized Vote No Campaigns against directors in 2009, at least 84 directors at 48 companies failed to attain majority support through August 2009 at more than 2400 companies where voting results were available”
 - “Of all director nominees who had more than 20% of shares withheld or voted or voted against them in board elections, nearly 60% served on compensation committees” (*Noted by Scott Fenn September 19, 2009*)
- Major institutional investor Fidelity voted against 23% of directors seeking election at U.S. companies (7/01/08 – 6/30/09), up from 17% the prior year, according to the Reuters report (*September 2009*)

Strategies to Counteract Loss in Broker Voting

Conduct a Vulnerability/Impact Analysis

With the loss of the broker vote, the vote of your institutional shareholders (proxy advisors) will have more impact

- Corporate Governance & Compensation Practice Review
- All institutional shareholders follow a specific set of proxy voting guidelines. Companies need to understand these policies and when shareholders may withhold votes or vote against your directors
 - What are the corporate governance and compensation related “hot buttons?”
- The recommendation of RiskMetrics (RMG) will carry even more weight
 - How many of my shareholders will be influenced by RiskMetrics?
 - In what instances will RiskMetrics issue a negative recommendation?
 - How will Glass Lewis review my proposal to elect directors?

Issues to Beware Of

Review Corporate Governance & Compensation Practices

- Pay for performance disconnect or other poor pay practices
- Excise tax gross-ups and/or reimbursement on perks
- Single trigger change in control agreements
- Repricing of underwater stock options without shareholder approval
- Negative recommendation on equity plans
- Adoption or renewal of poison-pill without shareholder vote
- Failure to address shareholder proposal that received a majority vote
- Poor accounting practices

Review Board Composition

- Director independence
 - Entire board
 - Key committees (audit, compensation, nominating)
- Poor attendance without valid reason
- “Over-boarded” directors
- Professional relationships

Ways to Improve Retail Holder Voting Response Rate

- Telephone Solicitations
- Reminder Mailings
- E-Mail Reminders
- Investor Education Programs (brokers, issuers, exchanges, etc.)
- Revisions to Notice Document
- Company Voting Inserts
- Reorganize Proxy Statement
- Separate Cover Letters

The Perfect Storm: Post 452 World

Perfect Storm of Director Related Issues & Activism



- Notice & Access
- Majority Vote on Directors
- “Just Vote No” Campaigns
- No communication with OBO’s
- Amplified institutional withhold/ against votes on Directors
- Pending Proxy Access



Thank You for Participating!

Contact us with any questions:

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