

Proxy Solicitation in an E-Proxy World  
is Part of a Broader Framework of Issues  
and Changes that have had a  
Dramatic Impact on Public Corporations

*Presented by:*



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Today, Activist Investors, Hedge Funds and Proxy Advisory Services fit within a framework that includes:

- Retail owner apathy
- Increased scrutiny by domestic institutional investors
- Greater media scrutiny
- Mutual Funds are being more activist due to reporting requirements

There have been dramatic changes in the perceived role of the Board of Directors; particularly in the last few years as Hedge Fund activism and the power of ISS has increased.

- Today, Directors in the U. S. have a much more difficult job than in past decades
- The time and responsibility are more demanding than ever before – yet, pay for Board service is often NOT increasing
- Knowledge of investor attitudes often doesn't reach the Board
- More tension between Boards & CEO's

## Key issues making things more difficult include:

- The print media are more aware of contentious issues and eager to pursue them
- Traditional shareholders are more aggressive
- Short-term investors are even more aggressive
- Regulators are more demanding and changing the rules
- Cable TV business programs have spread knowledge of business & business issues further than ever
- The pendulum of support has been moving away from companies on tough issues

# Underlying Historic Assumptions

- The Board of Directors is the guardian for shareholder interests
- One share = one vote
- Many/most shareholders have long-term focus
- Management's interests are aligned with the interests of shareholders
- These assumptions were the basis for Management/Board control of a company in the U. S. for many years
  - The reality today is that not all of these assumptions are still valid
  - I will revisit this slide at the end of my presentation

# Hedge Fund ownership & power fit within a historic framework

## Historically

- Activist actions:
  - Few changes at Board level or few decisions forced on Boards unless money was paid to shareholders

## Today

- Activist investors:
  - Seek to protect own investment against poor performance
  - Try to use proxy process to create better Corporate Governance
  - Press to create value by using investment and Board challenge as a tool to force change and increase cash distributed
- Changing nature of the Board of Directors
  - Hedge Funds create a certain level of fear
  - Lack of knowledge about level of Hedge Fund ownership and intentions also creates fear

- The evolution of Corporate Governance
  - Boards are becoming more sensitive to shareholder issues today, and in some cases less willing to fight
  - Also, some Boards today are perhaps too eager to placate shareholders
- Increased difficulty in identifying shareholders
  - How can a Board act intelligently when it does not understand who owns its shares?
- Proxy advisory services & their increased importance
  - 10 years ago few Boards knew what a Hedge Fund was let alone who ISS was
  - Today, almost everybody thinks carefully about ISS recommendations and worries about Hedge Fund activism

- Regulatory changes
  - Possibility of shareholder access to proxy
  - NYSE rule doing away with the routine broker vote
    - Not very significant news for large companies
    - Terrible news for smaller companies
    - Further developments are possible
  - NYSE halted immediate implementation; but new rule will likely take effect on January 1, 2008
  - Additional disclosure of beneficial owner information, which is what companies want, may not be made available as it requires SEC approval and the NYSE is NOT pushing for it

# Historical Overview of Activism

## 1970's

- Proxy fights were rare
  - Those that occurred were often where management probably really did not do a good job
  - Vote results were often close, historically, if the dissident party had any chance of winning
  - Normally, management wins were by large margins; dissidents by small amounts
- Boards were almost never unseated through voting mechanisms
- Many tender offers - Almost all succeeded
  - Securities only
  - Cash/securities
  - Cash only – eventually cash became king

# 1980's

- Era of anti-takeover proposals adopted by Shareholders at Board's request
- Countless companies put anti-takeover mechanisms in place – “Shark Repellent”
  - Almost all companies were successful when shareholders were asked to vote
- “Poison Pill” created by a top M & A attorney during hostile deal
  - Put in place at many companies by Board action alone

# 1980's

- “Poison Pills” adopted by many companies
  - Hardly ever used to block a takeover
  - Why? Board concerns and responsibilities eventually create an environment for a bid to succeed
- Era of junk bond financed hostile deals
  - Many successful bids by financially insignificant parties given easy access to money
- Proxy fights to remove Boards often tied to hostile deals
  - Sometimes Boards were challenged when they said “no”
  - Proxy fights ensued
  - High level of acceptance of offer desired

## Late 1980's

- A small, but growing, number of institutional shareholders begin to vote against Board sponsored proposals
- Institutions begin looking to outside service providers for assistance in making recommendations on how to vote shares

# 1980's – 2000's

- Emergence of individuals who targeted multiple companies over a period of years:
  - Carl Ichan
  - Asher Edelman
  - Irwin Jacobs
  - T. Boone Pickens
- Some of these individuals are still active 25 years or more after their early forays into corporate control battles
- Parties called “corporate raiders” in the 1980's are called “shareholder activists” today

## 1990's – Early 2000's

- Emergence of small groups who pooled money and targeted the Savings and Loan industry
- These battles were seen as a way to unlock value for an aggressor and for all of those who followed their investments by buying the target company's shares
- These pooled fund attacks are the precursors of today's Hedge Fund proxy fights

# 1990's

- Opposition to “Shark Repellent” by major institutions emerges as a factor
- Institutions and activist investors start campaigns to eliminate such defensive maneuvers
  - They start putting forward proposals to remove charter/by-law amendments
  - Companies almost always win and rarely take action even when vote level against the company is high. Though not winning outright victory, institutions make their feelings known and Boards consider reaction to the pressure they feel

# Late 1990's

- ISS emerges as a factor in corporate elections
  - Visits/calls by both sides become an important part of campaign strategy
  - Past Corporate Governance performance of a Company is considered
  - Responsiveness to shareholder concerns gains in importance
  - Current Corporate Governance policies begin to become a factor in vote recommendations

## Late 1990's – Early 2000's

- Companies begin to understand that the power to influence Board actions is concentrated in the hands of a limited number of large institutions plus a single decision maker – ISS
  - Traditionally, proxy solicitation firms did “vote projections” to guide companies how to win and who could be influenced
  - ISS power made this more necessary as it became harder for companies to win votes
  - When shareholders vote or may vote in a block against the Board's recommended action, success is more difficult to achieve

## Late 1990's – Mid 2000's

- Reduced impact of good relationships between Company Management and Portfolio Managers begins to become apparent as proxy voting at major institutions starts to move heavily to the proxy voting committee
  - Historically: more often than not relationship with a well run company would win out over the proxy committee
  - Today: proxy policy is the key factor, NOT the person who manages the investment

## 2000's

- ISS begins to play a truly major role in determining the outcome of votes on proposals
- HP and Disney are two key examples. They helped to propel ISS to a higher level of visibility and acceptance
- Proxy battles for Directors' seats or "Withhold Vote" campaigns become a more common tool to express dissatisfaction with Board actions
- Sometimes, individual Directors are targeted, NOT the entire Board

# 2002 - 2007

- Enron and other mega-bankruptcies begin an era of intense interest in Corporate Governance
- Regulatory developments:
  - NYSE Rule 452 – major change to historic voting by brokerage firms
  - Shareholder access to proxy – SEC has presented two conflicting approaches in August, 2007
  - NOBO/OBO – no change
  - The scales have tilted to give shareholders more power than ever before
  - This process is still in motion in the U. S.
  - The pendulum has swung 180 degrees from 25 years ago – from “pro-Board” to “pro-shareholder”

# 2004 - Present

- Hedge Funds begin to play an important role in forcing corporate actions. These include:
  - Change of Board Members
  - Sale of Company
  - Sale of Assets
  - Share Repurchase
  - Changes in Management

# Expansion of Global Voting Platforms Present a Possible Risk

- New economic imperatives for the Owners of these platforms to get traditionally apathetic institutional owners to vote

<u>Former name</u>	<u>Status</u>	<u>New Owner</u>
– ISS	sold	RiskMetrics
– Glass Lewis	sold	Xinhua Finance
– ADP	spun off	Broadridge is the new company's name

- All three companies have been sold or spun off in the last six months
- On May 21<sup>st</sup>, RiskMetrics, the new owner of ISS, announced the intention of doing an IPO by Fall 2007

In a more aggressive world, where there are a greater number of challenges to Boards of Directors, companies must know who their shareholders are

- Why has it become more challenging to do a thorough Share ID?
- Why is it so difficult to identify Hedge Fund owners?
- System has moved from one geared to cooperation at the Trust/Bank level to one where information is developed institution by institution

# What will influence the amount & type of available shareowner data?

- Many companies believe they have the right to know who 100% of their shareholders are. This is only true if the regulatory environment in a country requires this. Otherwise, companies do NOT have any rights beyond those provided by legislation.

- This is a key point
  - There should be a big push by companies to get OBO (Objecting Beneficial Owner) data. It is the investment banks that companies pay so well that are the key opponents and who help dictate NYSE policy
  - No guarantee of success in terms of greater disclosure
  - SEC focus on stockwatch business will hurt ability to identify shareholders
  - Board focus for first time on who owners are primarily because they are afraid of pressure from shareholders, particularly Hedge Funds

# How do Shareholder ID Firms Identify Shareholders?

## Historic approach:

- Excellent access to information
- Proxy cards
- Bank lists
- A relatively open environment
- A lot of information was available

## Current approach:

- Information is much harder to come by because of a change in attitude by custodians and legal concerns

- Current challenges:
  - Scandal in U. S. on payment for information
  - Banks have mostly stopped cooperating
  - Institutional opposition – Fidelity
  - Hedge Funds do not cooperate
  - SEC examination of the issue
  - Large, select owners may not share information with ID firm, but may share with the Company

- How different parties act:
  - The view of the Securities and Exchange Commission on Shareholder ID programs
    - Unknown
  - The view of traditional Institutional Owners
    - They often cooperate
  - The view of Hedge Funds
    - They want secrecy
    - NOT generally open about holding unless it helps them achieve objective
  - Objecting Beneficial Owners
    - Current law keeps their identities hidden
    - Financial community has sided with institutional clients vs. corporate clients on this issue for decades

# Can a Company track Hedge Fund ownership on an ongoing basis?

- Optimistic View:
  - Shareholder ID
  - 13-D, 13-G reporting
  - Personal Contact
  - 13-F Filings
- Pessimistic View
  - You will only learn what Hedge Funds want you to know
  - Some tracking of ownership by where shares are held is possible

# Hedge Fund Tracking Services

- Who are the Owners vs. how many shares unidentified Hedge Funds own or control?
  - Share ID efforts in the U. S. are now being supplemented by efforts by The Altman Group among others to track the % of shares held by Hedge Funds as opposed to the exact identity of Hedge Funds
  - This helps a company understand the likelihood of a large hostile accumulation even if the identity of Hedge Funds is NOT known
  - This is an on-going service in the U. S. based on daily, weekly, monthly availability of DTC list

# Establish guidelines to track Major Owner Groups

- This will allow you to track movement by categories of Owners
  - Traditional institutions
  - Management
  - Friendly parties
  - Retail
  - Hedge Funds, etc.
- Will help spot potentially aggressive accumulations by type if not by name of purchaser

# Can companies prepare for a Hedge Fund attack?

- Knowledge about the investor base is the key though NOT a guarantee of success
- Vital importance for companies to upgrade their IR efforts
  - This is to ensure that companies initiate relationships when there is no threat to the Company
- Urgent for top management to have personal relationships with largest shareholders by way of:
  - Roadshows
  - Telephone contact
  - Personal visits
  - Why? So investors understand corporate strategy and can help keep shares as fully valued as possible

# Who at a Company should care about accumulations by Hedge Funds?

- Often, little attention is paid to this issue at the highest levels
  - This is most true at small to mid-sized companies that are most likely to be attacked. This is NOT a well understood issue.
- IR Officers and or CFO's are often asked to track this information
- We believe the Board of Directors will become more active in requiring management to report to them on this issue

# Do Hedge Funds vote more shares than they own at Annual Meetings?

- Maybe. This can be a huge factor in the outcome of a proxy battle
- Vote buying/empty voting
  - Loans or a party whose voting rights exceed their net economic ownership

## Key Points from Academic Research on Hedge Fund Activism

- Traditional Institutional Investors have historically not started proxy fights –the free rider problem
- Hedge Funds increase their chances of winning proxy battles by “buying votes”
- Hedge Fund managers have a personal stake in winning and creating value for all shareholders
- Hedge Funds have become extremely successful in forcing Management and Boards to acquiesce to their demands
- Hedge Funds usually target successful companies – not underperforming ones
- Hedge Funds target cash rich firms and firms with low debt
- Tax reconciliation Act of 2003 helped to prompt Hedge Fund activism by reducing the tax on dividends

- There appears to be evidence of increased trading before 1<sup>st</sup> 13-D filing. There is some thought that Hedge Fund's alert others to their intentions shortly before filing their 13-D
- One study suggests there is no evidence that activist involvement improves operating performance after the initial investment in the firm
- The threat of a proxy fight is often enough to convince a company to acquiesce
- Even when companies decide to fight, they lose over 40% of such battles
- Hedge funds are not required to disclose their derivative positions
- A positive correlation has been established between mutual funds voting with management and the amount of pension business these funds have.
- Publicity over this issue has made it tougher to sway funds in the past 2 years.

- Prior to 2000, Hedge Funds traditionally profited from arbitrage trading opportunities. The rapid growth of the hedge fund industry has eliminated many of these arbitrage opportunities and have forced some funds to turn to activist investing
- Returns for Hedge Funds have been falling in recent years
- In one study only 10 companies or 2% were in the S & P 500. Therefore targets tend to be relatively small companies
- Hedge Fund activism spreads across companies in many industries
- Non-Hedge Fund activists are more interested in buying target firms than are activist Hedge Funds
  - Hedge Funds who get on Boards will find themselves restricted in their ability to sell shares
  - New Century and BKF are two examples of how election to a board can create a big problem
- Whereas Hedge Funds target relatively profitable, healthy firms. Other activists target lower performing companies

- News of the Hedge Fund filer to filing status (i. e. need to file a 13-D) seems to hit the market at least one week prior to the 13-D filing
- Excess cash drops in the fiscal year following the initial 13-D filing

# Hedge Funds Attack

- Success is a highly likely outcome

# Altman's Analysis of 2006 Hedge Fund Activism matches Academic Research Results

- Altman analysis shows two thirds of resolved Hedge Fund activist efforts (real or threatened) result in a win for the Hedge Fund
- Academic research for prior years supports our research showing 60%+ success rate for Hedge Fund initiated actions

# What types of entities start proxy fights or other vote campaigns?

- Union pension funds - AFSCME
- Government entities - Calpers
- Hedge Funds – Many Different Parties
- Large sophisticated investors (like Carl Ichan)
- Non-shareholders – Pfizer (IDAF)
- Other entities – i.e., Shareholder Advocacy Trust

# What role do ISS, Glass Lewis and other proxy advisory firms play in determining the outcome of votes on special proposals?

- ISS has a very large client base and is expanding internationally
- Glass Lewis is much smaller, is growing quickly and acts as a second opinion in the marketplace
- ISS works for corporations and meets with parties. Glass Lewis does not
- The influence of these firms is growing
- Interestingly, both firms have been purchased within the last six months by firms with private equity backing

# Mutual Fund Companies

- Currently, votes are less in favor of Management than historically
- It is more difficult to influence Portfolio Manager than in past years
- You may be able to meet with the Proxy Committee, but will it make any difference?

- NPX Filings:
  - Voting data is now public
  - Internal Compliance Department wants consistency
  - Media scrutinizes voting behavior by Mutual Fund Companies very carefully
- Fidelity has recently been targeted by media for ostensibly casting favorable votes for corporations who are also clients

# Impact of non-Hedge Fund Activists on Corporate Elections

- Influence is growing
- Success rate is increasing
- Boards are under increasing pressure
- Changing the way companies view anti-takeover defenses
- Changing the way companies respond to proposals they receive from shareholders

# Changes in Voting Patterns by Traditional Institutions

- Less built-in support for management
- More scrutiny of the votes they cast
- Role of stock loans in corporate elections
- Mutual funds must now file reports detailing how they vote
- Influence of ISS and Glass Lewis on voting

The Corporate Governance pendulum has clearly moved major owners away from usually supporting Management/Boards

- There is little likelihood the pendulum will swing back in the other direction

# Individual Voting by Institutions vs. Block/ Herd Voting

- Why has the trend moved so rapidly to block voting?
- Why have case by case decisions become such a challenge?
- Will the impact of ISS and Glass Lewis increase or decrease?
- Why are Institutions less concerned today about the impact a vote against management will have on their relationship with the Company?

# Short-termism

- A term used historically to describe the short-term focus companies have on producing quarter-to-quarter results.
- New definition relates to short-term time horizon of sophisticated investors expecting a quick payoff
- What impact might these short-term holders have on voting?
- Might short-term focus of aggressive investors force management to pursue Private Equity sale, thereby denying current shareholders the long term appreciation that might otherwise occur

## Parallel Investing

- Hedge Funds and others make investment decisions by tracking the activities of Activist Hedge Funds
- 13-D filings, Press Releases, and letters to Management/Board are seen as signals of hostile intent
- How can you detect these accumulations?
- How can you deal with the issues these accumulations create?

## What role should the Investor Relations Professional or Corporate Secretary have in Reporting Shareholder Concerns to the Board

- Where does your responsibility lie with regard to shareholder communications received by the Company?
- Is it to Senior Management or the Board?
- Major owners believe their access to the Board is blocked by senior management and company executives

# What can a Company do?

- Carefully track who your holders are
- Increase IR efforts overall
- Visit with major overseas owners as well as key domestic owners
- Involve senior management in reaching out to a greater number of Institutional owners
- Try to increase your retail shareholder base
- Don't believe everything Hedge Funds tell you
- Don't allow Hedge Funds to bully you
- Don't treat all Hedge Funds as potential enemies
- Engage major owners in conversation
- Be prepared to fight for what you believe in
- Be prepared to be disappointed by some long-term holders

# Underlying Historical Assumptions

- Board of Directors is the guardian for shareholder interests
  - Historically: not always accurate
  - Today: more true today than historically
- One share = one vote
  - Historically: true
  - Today: less true today than ever before due to market mechanisms that separate economic interests from voting rights

## Underlying Historical Assumptions (continued)

- Many/most shareholders have long-term focus
  - Historically: generally true
  - Today: less true today than ever before
- Management's/Board of Directors interests are aligned with those of the shareholders
  - Historically: sometimes true
  - Today: a strong trend is underway that aligns the interests of all parties, except when the Board decides to take the company private

# The new world of e-proxy

Notice & Access - what is it and how does it work?

- The “40 day” notice
- Access to proxy material
- Availability of hard copy option to holders
- Voting
- Logistic / process
- Ability for shareholders to use Notice & Access to solicit proxies
  - ✓ Lower cost = more proxy fights?

# E-proxy: Regulatory update

- Voluntary July 1 – Dec 31 2007
- Mandatory for large accelerated filers – Jan 1, 2008
- Mandatory for all companies – Jan 1, 2009

# E-Proxy – how will it affect you

- Minimal impact on institutional vote (already get it electronically)
- Impact on retail vote – decreased response
- What is your shareholder profile?
- For companies with high retail shareholder constituencies:
  - No more broker discretionary vote (when it happens)
  - Majority vote standard
  - Institutional (ISS) withhold votes on certain directors
  - Activist withhold campaigns

Losing votes from your most loyal shareholder constituency may have serious implications.

# Thank You



**The Altman Group, Inc.**

**Winner of 2006 TOPS Award  
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