KINGSDALE Advisors

PROXY SEASON REVIEW 2017

SUCCEEDING IN THE NEW PARADIGM OF CORPORATE GOVERNANCE

Kingsdale Advisors' highlights of this year's proxy season, important developments in governance, and trends that will matter in 2018.

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NOVEMBER 2017

I'm excited to have recently joined Kingsdale Advisors to lead our U.S. business as we leverage our significant experience and exceptional capabilities to help clients and their advisors navigate the increasingly complex landscape of corporate elections. At Kingsdale, we've established ourselves as a leading global strategic shareholder advisory and proxy solicitation firm by consistently delivering the best service and unparalleled results for our clients. To ensure this foundation for success remains strong, we are continuously challenging ourselves to raise the bar and innovate.

After each proxy season, we take time to review the landscape, ask tough questions about what the latest developments mean for our clients and seek to identify trends before they emerge. This means carefully observing and analyzing market changes; establishing governance best practices; interpreting what the latest activist techniques will mean; reflecting on successful proxy fight strategies; and forecasting the tendencies of proxy advisors so that when you hire us, together we'll be ready for anything.

Our commitment to identify and solve unforeseen challenges has made Kingsdale more than just a proxy solicitor. We are a trusted strategic advisor to management and boards on everything from governance to shareholder activism to M&A. Over the last year we have further solidified this position by growing our team of dedicated governance professionals with the addition of Victor Guo, Executive Vice President, Governance Special Situations, who joins us from ISS where he was Vice President of M&A and Proxy Contest Research for the U.S. and Canadian special situations research teams. Guo joins Victor Li as co-head of our Governance group. Victor Li was also a former senior member of ISS. Throughout this publication, you will see governance take center stage, reflecting its growing importance to both issuers and shareholders.

Last year we identified a number of key issues and made predictions to the benefit of our clients:

- In our 2016 report, we warned about the growing stratification of activist types, specifically the rise of the 'constructivist'. As predicted, this year saw more activists willing to negotiate behind closed doors, leading to a slight decline in the number of public proxy contests – read more about it on page 5
- Last year we suspected proxy advisors, particularly Institutional Shareholder Services, were poised to become more stringent on say-on-pay votes and provided some tips about how to avoid a negative recommendation. 2017 has seen ISS recommend against 283 (a record high) say-on-pay votes– read more about our say-on-pay analysis on page 13
- As with the rise of the 'reluctavists' we mentioned last year – that is those shareholders who adopt an activist stance as a last resort – traditionally "passive" investors have become more active, presenting a new dynamic issuers cannot ignore – read more about it on page 17
- We placed a big emphasis, as we do every year, on the need to engage shareholders. For those who did, you will notice an increasing focus on Environmental, Social, and Governance (ESG) issues in governance circles. In response to that, on page 7, we provide you with key ESG trends you need to be aware of and what you can do to make sure you are prepared to meet changing expectations.

We hope you find this report useful as you plan ahead and prepare for the most unexpected challenges. As always, we view this report as the start of a conversation and remain on standby to assist with your needs.

Best regards,

Michael Fein
Executive Vice-President,
Head of US Operations

PROXY SEASON REVIEW

section

01.

CONTESTS – OVERVIEW & HIGHLIGHTS

Despite drop in public proxy fights, activism remains a pervasive and effective tool for investors.

More than three-quarters of the way through the year, public proxy fight activity has somewhat cooled relative to the last two years. While 2015 and 2016 were record years for public calls for board representation, with 222 campaigns and 238 campaigns, respectively, the 135 public campaigns so far in 2017 show activism continues to be a robust investment class and a continued threat to public companies, regardless of size.

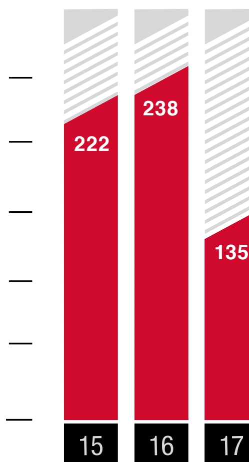
It is important to note that public activism is neither always the goal nor the result. Both companies and activists are finding new ways to work more constructively behind the scenes to realize what they hope to be value-enhancing solutions, while avoiding the significant expense and reputational exposure of a proxy contest.

On a macro level, we observe three takeaways. First, companies are becoming increasingly well-defended, making it more difficult for activists to identify vulnerable targets.

Second, it's important to not mistake a reduction in fights for a reduction in activity. Although recent, high profile proxy contests at Procter & Gamble and ADP have gone the distance, the default position for both activists and issuers is no longer going to war; diplomacy and settlements have prevailed with increased frequency.

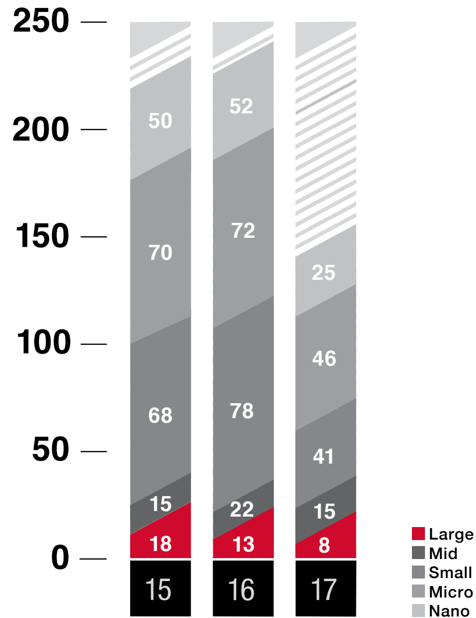
Third, the increased sophistication of activists has enhanced their credibility, as well-thought-out investment theses are becoming more readily acceptable to management and boards — and to their institutional investors.

Public Demands for Board Representation (US)



*As of October 10, 2017 – Per Activist Insight

Board Representation Demands by Market Cap



*As of October 10, 2017

This year, we saw a slight increase in success rates for activists demanding board representation. Activists won some or all of their objectives - or came to a compromise or settlement - in 72.3% of the public demands in 2017, whereas the activist success rate was just 69.7% and 70.7% in 2016 and 2015 respectively.

We see a couple of reasons for the uptick in activist wins. First, is the increased scrutiny and screening activists apply at the front end - meaning they are weeding out those companies who are best-prepared and targeting some of the weakest management teams and most vulnerable boards. Second, while activists may have an ideal scenario they want to see implemented, if the stock is up and they're making money, they may be willing to conclude that partial improvements will suffice.

PROXY CONTEST HIGHLIGHTS

This year has further demonstrated that market cap is not an effective deterrent to activists. The Trian-P&G proxy contest was a clear example that even the largest companies can be a target. Of particular note is the huge amount of money being spent in high-stakes fights for board seats. Although P&G may have eked out a win by the slimmest of margins — a reported 6.15 million votes, or 0.2 percent of the company's shares outstanding — one wonders whether it will be a considered a Pyrrhic victory given the strong mandate Trian received and the vast expense and distraction incurred by P&G. As more and more money is being spent on campaigns, the tactics to solicit shareholder support —particularly in companies that have a meaningful retail component—have evolved. YouTube videos, billboards, newspaper ads, text messages, and pre-loaded video players introducing director nominees have all been used in an attempt to communicate with shareholders in the most resonant manner.

Activism in Transactions

The latest proxy season included a number of campaigns where leading activists were either catalysts for transactions or opposed deals in an effort to break up a transaction or extract greater economics from the buyer.

JANA's efforts at Whole Foods led to the company's sale to Amazon after a highly-publicized call for the company to either overhaul its operations or look for potential buyers following seven consecutive quarters of decreasing same-store sales. Starboard Value had been pushing for a transaction at Yahoo! since their 2014 call for the company to merge with AOL and ultimately saw their investment thesis play out with the company's sale to Verizon earlier this year. Although Eminence Capital and Hudson Bay's public opposition to Sabra Health Care REIT's acquisition of Care Capital Properties fell on deaf ears with the transaction receiving requisite shareholder support, activism continues to play a role in M&A as investors attempt to both initiate and thwart transactions. Marcato is currently pushing for a sale of Deckers Outdoor Corp. and JANA had opposed EQT Corp.'s proposed acquisition of Rice Energy. Regardless of the outcomes, evaluation of a company's shareholders and analysis of their anticipated support is critical to getting deals closed. And ideally this exercise should be done sooner rather than later.

COMPENSATION

COMPENSATION CONCENTRATION

As issuers' practices continue to move towards equilibrium with the guidelines and expectations of institutional investors, the average support has climbed, reaching 91.7% in 2017 — the highest average support since say-on-pay voting began. Such generally high support may be a blessing or a curse however — while companies may be less concerned about a proposal that negatively affects so few, that very fact incentivizes institutions to be especially critical of companies they feel are not meeting expectations. As such, the unofficial bar for 'passing' remains much higher than the official threshold, with ISS and Glass Lewis applying additional scrutiny to companies that fail to break 70% and 75% respectively.

Increased ISS Scrutiny

This year, we tracked a record 283 ISS against recommendations. Among companies receiving against recommendations from ISS, the average support level ended up at roughly 69%, indicating either a significant impact from ISS recommendations or significant overlap between ISS' and institutional guidelines.

This also shows the two prongs of ISS' approach — quantitative pay-for-performance tests and qualitative reviews of all aspects of the compensation program — are both important.

Having said this, a negative ISS recommendation is not the end of the line. Shareholder composition, of course, is an important determining factor and ISS' influence will depend on the degree of its subscribers within an issuer's shareholder base and their adherence to ISS' recommendation. Companies with significant or strategic shareholders that are supportive of management may find it easier to bypass a negative ISS recommendation. However, shareholder engagement remains one of the best defenses for a say-on-pay controversy regardless of shareholder composition.

Companies Failing in 2017

A total of 30[2] US incorporated companies failed say-on-pay this year, only three fewer than 2016's full-year total and down 19 from 2015's record-high.

COMPANY NAME	Ticker	Base	For/F+A%	For/F+A+AB%	Result
Nuance Communications, Inc.	NUAN	F+A+AB	33.5	33.2	Fail
Microsemi Corporation	MSCC	F+A+AB	45.4	45.4	Fail
Immunomedics, Inc.	IMMU	F+A	38.4	37.8	Fail
Sprouts Farmers Market, Inc.	SFM	F+A+AB	43.3	43.1	Fail
American Axle & Manufacturing Holdings, Inc.	AXL	F+A+AB	38.8	38.7	Fail
Whitestone REIT	WSR	F+A	43.1	42.4	Fail
ConocoPhillips	COP	F+A+AB	32.2	31.9	Fail
Senior Housing Properties Trust	SNH	F+A	46	45.6	Fail
Medifast, Inc.	MED	F+A	42.2	41.7	Fail
Sanchez Energy Corporation	SN	F+A+AB	47.8	47.3	Fail
Atlas Air Worldwide Holdings, Inc.	AAWW	F+A+AB	32.9	32.4	Fail
Tutor Perini Corporation	TPC	F+A	42.3	42.3	Fail
Endologix, Inc.	ELGX	F+A+AB	40.5	40.4	Fail
Rockwell Medical, Inc.	RMTI	F+A	25.9	25.3	Fail
SL Green Realty Corp.	SLG	F+A	42.8	42.7	Fail
Nabors Industries Ltd.	NBR	F+A+AB	44	43.7	Fail
New York Community Bancorp, Inc.	NYCB	F+A	49.7	48.5	Fail
IMAX Corporation	IMAX	F+A	30	29.6	Fail
Spectrum Pharmaceuticals, Inc.	SPPI	F+A+AB	43.9	43.7	Fail
SeaWorld Entertainment, Inc.	SEAS	F+A+AB	42.6	42.5	Fail
SandRidge Energy, Inc.	SD	F+A+AB	52.1	42.8	Fail
Universal Insurance Holdings, Inc.	UVE	F+A+AB	47	46.6	Fail
Hospitality Properties Trust	HPT	F+A	48	47.7	Fail
FleetCor Technologies, Inc.	FLT	F+A	37.4	37.3	Fail
Argan, Inc.	AGX	F+A+AB	45.4	45.3	Fail
Mylan N.V.	MYL	F+A	16.5	16.4	Fail
PHH Corporation	PHH	F+A	36.3	35.9	Fail
Bed Bath & Beyond Inc.	BBBY	F+A	43.9	43.8	Fail
McKesson Corporation	MCK	F+A+AB	26.6	26.4	Fail
Virtusa Corporation	VRTU	F+A	37.3	36.4	Fail

[1] Semler Brossy 2017 SoP Results, 9/13/17

Key Themes for the 2017 Proxy Season

In reviewing countless proxy statements and supporting our clients as they prepare for their say-on-pay votes, we have noticed several key themes and challenges to keep in mind for the 2018 proxy season.

Performance goal rigor scrutinized: This year, we see increasing scrutiny over the rigor of performance goals within pay programs and we expect this trend to continue. Whereas previously shareholders would look at whether these metrics were disclosed (e.g. target, threshold, and maximum goals), now they look at whether the targets themselves make sense.

Absent other information, a common evaluation on the quality and rigor of goals is the comparison to look-forward target goals against the historic target goals, as well as the actual achievement and market guidance. When future targets are set below past levels or results, proxy advisors and shareholders often raise concerns. But there may be legitimate reasons as to why targets do not necessarily trend upwards indefinitely year-over-year, and this does not always indicate a failure to implement stretch goals. Planned capital events can be a major swing factor. Where these can be controlled by management, any positive variance narrative must be watertight. For example, free cash flow targets may increase or decrease depending on the business cycle and corporate strategy. Companies know best the story behind shifting targets, so the onus is on them to elaborate on these nuances in their CD&A disclosure and ensure shareholders understand.

HR must talk with IR: Performance goal targets may be assessed via corroboration from other public sources like statements made in earnings calls, corporate presentations and audited financial statements. Shareholders will increasingly draw parallels between what management is saying and how management is measured and paid because governance teams at institutional investors often interact with portfolio managers. Enhanced communication between HR and IR teams is prudent because any publicly disclosed metric and corresponding targets may be picked up by shareholders and proxy advisors. For example, a bullish statement made on an earnings call for a return-based metric without the corresponding stretch targets in the short-term incentive plan (assuming the metric is part of the plan) may raise questions regarding the plan's rigor. In one case last year, a CEO's performance target was set not only below actual current achievement but also well below market guidance given. Shareholders picked up on the fact that it looked like a 'guaranteed' award. Yet another reason why it is important for companies to tell their own pay for performance story in the CD&A.

Shifting of performance cycle for long-term incentives: We see an increased need for companies to shift long-term incentive granting cycles to after year end for the performance year prior. Granting long-term incentive awards, primarily based on 'benchmarking' in the year performance is measured, is problematic on two fronts. First, in-the-year grants restrict the board's ability to adequately consider year-end performance before determining the size of grants. When shareholders assess pay-for-performance, they look at year-end performance. Hence, it makes sense for the board to have the same information shareholders have before deciding on the size of long-term incentive grants.

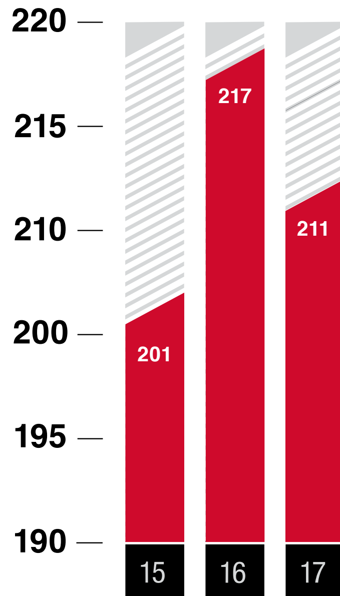
Secondly, given that equity awards usually represent the largest component of total direct compensation, boards that practice in-the-year grants running into pay-for-performance problems can only resort to short-term bonus reductions or, in more extreme situations, forfeiture of previously granted equity. Neither of these options is palatable, as equity award forfeiture is cumbersome and bonus reduction or elimination may not be enough to alleviate shareholder concerns. For companies that choose to forfeit short- or long-term incentive awards after shareholder backlash, we see this as a less effective reactionary approach, as shareholders assess a board's intention at the time of the grant more closely than the actual grant itself. Therefore, to afford the board more runway in preparing for say-on-pay, an after-the-year grant of long-term incentives, preferably based on well-defined performance metrics, represents the best approach to mitigating surprise pay-for-performance concerns.

Fundamentally, whatever the components of executive pay, if there is excessive pay relative to performance and shareholder value experience, expect a problem.

More Companies with Less Than 75% Support

Tracking the number of companies with sub-75% support levels, we see a general increase since 2015, with 2017 on track to be the year with the greatest number of companies failing to reach this 75% threshold with 211 YTD.

Number of Companies Below 75% Support



We see this as a general trend of shareholders becoming more active on pay issues. Given that Glass Lewis' board responsiveness threshold is 75% (ISS' threshold is 70% for say-on-pay), boards must be more diligent than ever in combating potential compensation controversies before they surface and before a seemingly benign advisory vote leads to withhold recommendations on directors.

Governance Developments

Emergence of Virtual AGMs

Virtual meetings have been prevalent and growing in the U.S. According to Broadridge Financial Solutions, the largest provider of virtual meeting services, at least 250 U.S. companies will host virtual meetings (both virtual-only and hybrid as discussed below) in 2017, up from 187 in 2016.

In contrast to conventional physical shareholder meetings, virtual meetings allow individuals to participate from the comfort of their homes. Although issuers often provide an online webcast of their shareholder meeting, it is only truly virtual if it preserves the features of a traditional meeting by giving registered shareholders and proxy holders the ability to vote at the meeting. Virtual meetings can be categorized as "hybrid" – meaning the issuer has a parallel physical meeting and virtual component or "virtual-only" – meaning the only way to participate is online.

Virtual meetings are still a somewhat nascent development and most major institutions have yet to take a public stance on the subject. However, there is some indication that hybrid meetings will meet considerably less potential resistance than virtual-only. ISS recently announced feedback from its 2018 policy survey indicating that more than two-thirds of investors found hybrid meetings acceptable. In the same ISS survey, these investors were roughly split with regards to virtual-only meetings, with 36% of investors not finding them acceptable and 32% satisfied so long as they provided the same shareholder rights as a physical meeting. Additionally, several pension funds have recently indicated a preference for hybrid over virtual-only meetings. In one notable example, New York City Comptroller Mr. Scott M. Stringer has taken a negative view of virtual-only meetings, claiming that they stifle corporate accountability and limit transparency. According to its recently published proxy voting policies, the New York City Pension Funds may withhold votes from directors on the governance committee if issuers host a virtual-only meeting.

Considering A Virtual Annual Meeting

If you are exploring the potential for a virtual or hybrid meeting, here are some key insights to consider:

- Hybrid meetings are and will be viewed favorably by shareholders because they broaden shareholder access while maintaining all the features of a conventional in-person shareholder meeting
- Issuers will need to be cognizant of possible backlash associated with adopting a virtual-only meeting, especially as views on the topic continue to evolve. Shareholder proposals to eliminate virtual meetings and negative press associated with adoption are some of the risks issuers will face. To mitigate such risks, issuers should consider adopting and disclosing procedures related to their virtual-only shareholder meeting (including any Q&A component) in order to improve process transparency
- Adopting a hybrid meeting affords issuers the opportunity to "test the waters" prior to transitioning to a virtual-only meeting
- Newly-listed companies have the greatest likelihood of shareholder acceptance of virtual-only meetings as they have never held a physical or hybrid meeting so there is no connotation of shareholder rights being marginalized

Director-Shareholder Engagement

Director-shareholder engagement is quickly becoming the norm — not only because more investors are becoming increasingly clear they want access to independent directors, but because directors themselves are coming to understand the value of getting out from behind boardroom doors: the ability to socialize shareholders to important decisions, showcase board expertise, create self-awareness and understanding of expectations, and build trust and personal capital.

While some companies may be informally engaging shareholders on an ad hoc basis and not reporting on it, it is important to understand that a growing number of shareholders want to see formal policies and proof of engagement.

In surveying the top 15 companies in the S&P 500, we have found that while there is a wide disparity in the degree to which formal engagement efforts are disclosed, all but two indicate that board directors are involved in the engagement process.

Proxy Advisor Initiated Engagement

Broadly speaking, ISS' and Glass Lewis' benchmark guidelines currently describe situations that require board engagement and responsiveness, mainly in reactive circumstances.

One of ISS' fundamental principles when determining vote recommendations on director nominees is board responsiveness. Within ISS' benchmark guidelines, they outline specific cases where board communications and responsiveness are expected.

ISS clearly outlines what it considers appropriate board responses which may include, "disclosure of engagement efforts regarding the issues that contributed to the low level of support, specific actions taken to address the issues that contributed to the low level of support, and more rationale on pay practices" among other things. Beyond say-on-pay, if a management proposal fails or a shareholder proposal passes, ISS will expect the board to be responsive and engage shareholders.

Similarly, Glass Lewis believes that any time 25% or more of shareholders vote contrary to the recommendation of management, the board should demonstrate some level of engagement and responsiveness to address the shareholder concerns. Particular to compensation issues, Glass Lewis believes, *"the compensation committee should provide some level of response to a significant vote against, including engaging with large shareholders to identify their concerns."*

Typically, issuers can demonstrate responsiveness by engaging shareholders and soliciting their feedback on concern items, enacting and adopting changes and modifications, and then disclosing such changes publicly via their proxy statement. Engagement efforts should also be described in depth within the proxy, including who was involved, aggregate level details on shareholders engaged and changes made as a result.

Shareholder Engagement is the Precursor to Vote Success

As the elected representatives of shareholders, it is critical that independent directors not only participate in shareholder engagement but assume a leadership role. While some directors will continue to drag their heels over concerns about the risks of sitting down face-to-face with an investor, we think a bigger risk is not knowing where your shareholders stand. In choosing whom to involve in the engagement process, issuers should consider a director's specific role on the board, e.g, committee positions, as well as their ability to speak competently and comprehensively relative to the engagement topic. This last point may seem obvious, but is not always put into practice. Issuers should work with their consultants and advisors to ensure that directors receive the practice and training necessary to communicate with investors in a positive and productive manner.

ANTICIPATED DEVELOPMENTS/ LOOKING FORWARD

section

02.

ESG

Environmental, social, and governance (ESG) issues are quickly moving from a small subset of concern for investors to a core philosophy about how they invest and how they expect the businesses they own to behave. Investors are becoming increasingly interested in companies' ESG profiles alongside their fundamentals, while companies may find it challenging to understand how their ESG profile will be understood and benchmarked.

This year, ESG proposals have gained both interest and support among investors, with climate change emerging as the dominant shareholder proposal topic. While the governance aspect is nothing new, an emerging laser focus on environmental and social issues has been observed.

What is Driving the Rise?

There are several factors that are simultaneously driving the rise in ESG investment practices. The first is the acknowledgement that issues such as climate change and human rights are affecting various sectors across the economy, and that the incorporation of ESG considerations can be used as a risk-mitigation screening process when evaluating companies. There is a belief that institutional investors are incorporating ESG factors in their investment processes to identify higher quality companies with strong management teams. Typically, management teams of companies with robust sustainability profiles have a reputation of being able to quickly adapt to changes, better manage risk, and take advantage of opportunities. Similarly, long-term investors may see ESG policies as a foundation for long-term success. Subsequently, such considerations may provide alpha-generating signals to help garner long-term investment performance.

Second, the Paris Agreement and the support from 195 countries has established climate change as a recognized global concern, with reactions to recent statements by the President only serving to underscore this view. The international treaty has increased investors' acknowledgement of the potential impacts climate change may have on investment portfolios. This recognition has resulted in conversations regarding portfolio de-carbonization and the pressure for issuers to provide greater disclosure regarding climate change-related risks.

The third factor generating greater demand for ESG-related investing comes from the growing number of millennials engaged in wealth management. Millennials represent the largest demographic in North America's workforce, and are estimated to inherit more than $30 trillion in the next few decades. According to a 2015 survey conducted by U.S. Trust, Bank of America, approximately 85% of millennials consider social or environmental impacts to be important to investment decisions. This contrasts with baby boomers who were interviewed, with only 49% agreeing that social and environmental impacts are important to investment decisions.

It is worth noting that Europe has historically been at the forefront of responsible practices, with approximately 65% of global responsible investing AUM, rendering it the largest region for responsible assets globally. Still, responsible investing has experienced international growth. For example, at the start of 2016, global responsible investing assets reached $22.89 trillion, representing a 25% increase from 2014. In nearly every market, responsible investing grew in both absolute and relative terms since 2014.

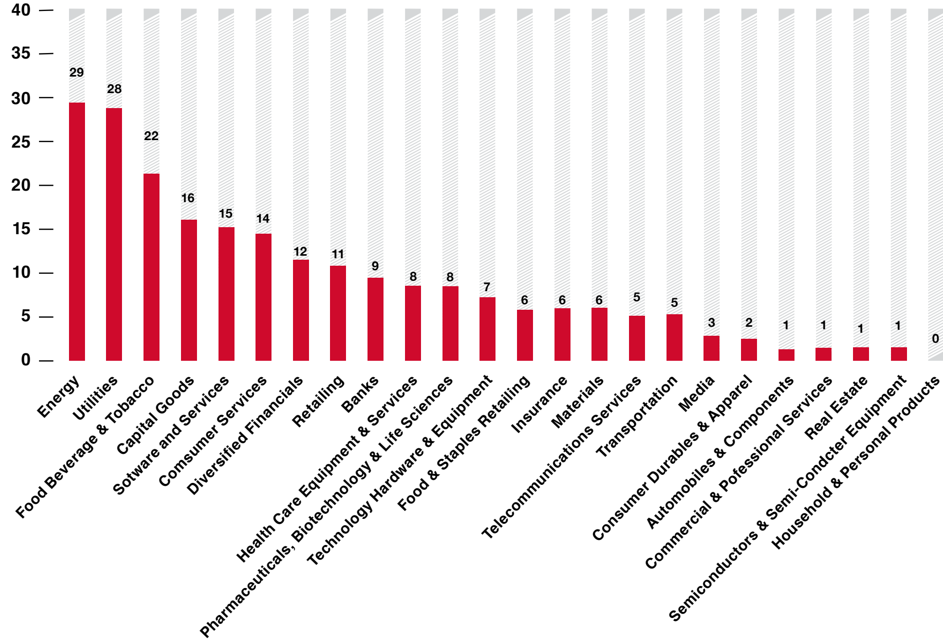
Several investment market players in the U.S., Canada, Australia, New Zealand and Asia have begun ESG integration as part of their investment screening. For example, one of the largest Canadian pension funds recently announced its plan to reduce the carbon footprint of its overall portfolio by 25% by the year 2025, making it the first North American institutional investor to set a carbon target covering all of its asset classes. In the U.S., responsible investing grew by 33% in 2016, representing $8.72 Trillion, compared to 2014.

A closer look at the ESG landscape shows a total of 216 ESG-related proposals have been voted on by shareholders in 2017, with 25 being climate change-related proposals. A majority of those climate change-related proposals were generic, requesting that the company provide a report outlining its strategy to prepare for a low-carbon economy and/or assess the long-term impacts that climate change policies may have on a company's portfolio. Ten proposals were more specific in nature, requesting that a company publish annual reports and disclose the long-term portfolio impacts both technological advances and climate change policies will have on the company, in addition to assessing the resilience of a company's full portfolio of resources, and identifying financial risks associated with different scenarios.

In 2017, the sector to receive the most ESG-related proposals *(Figure A)* was the energy sector (total of 29), closely followed by the utilities sector (total of 28), with the following sectors actually having ESG-related proposals pass: energy (3), utilities (1), technology hardware & equipment (1), and real estate (1).

Figure A

Number of ESG Proposal per Sector (U.S., YTD)

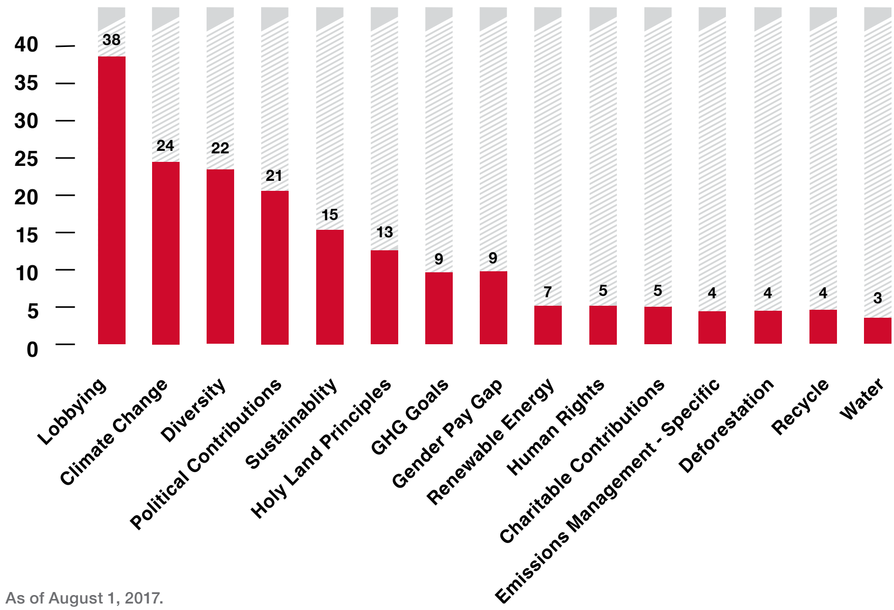


As of August 1, 2017.

The most popular ESG topics for 2017 are noted in Figure B, with proposals relating to lobbying, climate change, diversity and political contributions being the most popular issues.

Figure B

ESG Proposal Topics Voted in 2017 (U.S.)



As of August 1, 2017.

This proxy season has seen six ESG proposals pass, with the topics concerning climate change (3), diversity (2), and sustainability (1). Most notable are the climate change-related proposals that passed at Exxon Mobil Corp., Occidental Petroleum, and PPL Corp., all receiving majority support (62%, 65% and 56% respectively).

More Stringent Investor Views on ESG

Although a small portion of ESG-related proposals gain enough support to pass, it is how institutional investors vote that indicates ESG is becoming a growing concern among investors and an increased risk to boards. We have seen more and more large institutional investors changing voting policies to address ESG-related risks.

This year BlackRock, Vanguard and Fidelity amended their voting policies to be able to support climate change proposals. Furthermore, institutional investors such as State Street, BlackRock, Vanguard, Norges Bank Investment Management, and CalPERS, to name a few, have identified specific ESG topics they focus on when engaging with investee companies. State Street Global Advisors, for example, voted 'FOR' roughly 1/3 of the E&S proposals they saw this year. Given the size of portfolio at State Street, their peers, and the typical weight of their holdings in an investment, this evolution can translate into an enormous swing in support. And with a simple policy or guideline update being the only thing standing between a FOR or AGAINST vote, the change can happen essentially overnight — a few institutions updating their policies can move a proposal from being a minor annoyance to a potentially majority-supported item.

There are other international initiatives that underpin the rise of ESG. For instance, On June 29, 2017, the Financial Stability Board's Task Force on Climate-related Financial Disclosures published its recommendations for financial firms to disclose how climate change affects their business. Since its publication, eleven major banks including UBS AG, Citigroup Inc. and Barclays Plc (representing more than $7 trillion AUM) started a pilot project to implement the recommendations. Such initiatives may signal that in the future responsible investing will move from peripheral to mainstream focus.

How do Glass Lewis and ISS Approach ESG Proposals?

ISS and Glass Lewis have made it clear through a series of initiatives that ESG will be a big focus going forward with both proxy advisor firms having recently partnered with ESG research organizations. In 2015, ISS acquired Sweden-based Ethix to form ISS-Ethix, which helps clients develop and integrate responsible investment practices. ISS also announced a strategic partnership with the ESG intelligence provider RepRisk to offer clients access to RepRisk's ESG platform. The Reprisk platform enables clients to manage reputational, compliance, and investment risks related to ESG issues and serves as a screening tool to monitor portfolio companies' activities for purposes of investment analysis, engagement, or exclusion. Most recently, ISS acquired Zurich-based South Pole Group, a provider of ESG data and analytics to enable investors, asset owners, fund managers and banks to measure the impact of climate change on their portfolios. In addition, ISS already has several specialty proxy voting guideline policies that reflect ESG concerns: socially responsible investment (SRI), sustainability, and the faith-based policies. Similarly, Glass Lewis partnered with Sustainalytics early this year. Sustainalytics is a leading provider of ESG research, ratings and analysis. Given this partnership, Glass Lewis now integrates Sustainalytics' ESG research and ratings into their proxy research and vote management platform. Glass Lewis subscribers will now have access to Sustainalytics' ESG rating of issuers as Glass Lewis reports now include Sustainalytics' evaluations within their company reports.

Glass Lewis has stated that Sustainalytics' company ESG rating does not impact their own assessment and/or recommendations regarding issuers. However, it is important for companies to keep an eye on the big picture – as more institutional investors are identifying key ESG topics/concerns, published ESG ratings may become more relevant and impactful in the future.

What Next?

If an issuer is not in the highly-targeted extractive industries, that does not mean they are immune. Shareholders will be looking to see who you do business with and try to extend your influence to your vendors. Given the ESG trends identified above, issuers should prepare themselves for investors' increased demand for enhanced disclosure. One disclosure method is a sustainability or corporate social responsibility (CSR) report that would be updated at least biennially. Additionally, companies should keep abreast of, and consider participating in, climate change and sustainability reporting frameworks such as the Global Reporting Initiative and the Carbon Disclosure Project. By participating in sustainability reporting frameworks and/or providing quality disclosure regarding sector-specific ESG risks, issuers can be proactive in addressing potential shareholder concerns. A proactive approach can help reduce the probability of issuers receiving shareholder proposals, as shareholders are more likely to target those companies with a reputation for being a laggard on ESG initiatives and disclosure as compared to sector peers.

As time passes, it will be expected that issuers integrate climate change risks and opportunities within their corporate strategy. Issuers should ensure that their board composition has the required expertise to address environmental and social issues, in addition to allocating this responsibility to a specific committee.

Lastly, issuers should inform themselves of large investors' ESG voting policies and engagement topics, and ensure that key issues are addressed in their CSR reports. It would be remiss to omit highlighting that IROs and boards should focus not only on their current shareholders, but prospective ones. With the increased focus on ESG-integration, falling behind in ESG disclosure may mean that prospective shareholders skip out on an investment in your company.

ACTIVE-PASSIVE

For years we have warned not to paint all activists with the same brush and localize where an activist action or dissension against management could be initiated from. An activist action does not necessarily need to be precipitated by a traditional short-term activist. Today we see growing evidence the world's largest investors have been stirred and issuers would be well served to forget their traditional categorization of investors.

What is Changing at the World's Largest Investors

Historically, passive index funds have bought shares in a company based on a proportion in a specific index, paying little attention to individual corporate strategy or management. But to think that passive institutional investors – from index funds to mutual funds to pension funds to sovereign funds— don't have the capacity or interest to watch over their massive portfolios would be a mistake. While you would be right that very few would initiate a proxy fight, more are willing to support an activist and even more are willing to vote against you on key governance issues.

While some large investors have long-held underlying funds with differing strategies, some with very active teams, passive investors as a whole have been increasingly pressured to push returns and are pursuing a more activist stance as a necessity, not simply a preference. Coupled with this, pressure has continuously mounted in a post-Enron world to ensure accountability and proper stewardship of shareholder dollars. Those whose money the passive funds manage want to be confident underperforming companies, bad management, and governance laggards are being held accountable.

Gone are the days where passive investors could be considered passive when it comes to governance or voting. Those are now seen as key levers for long-term growth and, while there may have been some of this happening behind the scenes, some passive investors have started taking more public actions. Passive investors who hold poorly performing stocks no longer need to face the binary choice of sell at a loss or continue to be disappointed. The new option of influence to create the change you want has emerged. As BlackRock CEO Larry Fink has commented, index funds "can't sell those stocks even if they are terrible companies. As an indexer, our only action is our voice and so we are taking a more active dialogue with our companies and are imposing more of what we think is correct"[1].

By way of example, BlackRock reached out to companies that lacked gender diversity on the board and received shareholder proposals on the topic. Following the engagements, BlackRock supported eight of the nine shareholder proposals and voted against the nominating committee members at five companies for failing to address investor concerns related to board diversity.

Similarly, Vanguard has published examples of recent engagement efforts to promote change at their portfolio companies including having a dialogue with a real estate company and an activist shareholder to encourage board change and a successful engagement with a consumer products firm which led the company to make adjustments to executive compensation.

While engagement coupled with a large, long-term position can be enough to effect change, more and more passive investors are prepared to use their votes to send a message to directors and influence the direction of the companies they own, adopting a more 'longer-term activist' approach. Whereas checking a box used to be a formality, it is now a strategic choice passive investors understand can prove valueable in their search for alpha. Investors who are committed to a buy and hold strategy recognize that 'holding' doesn't mean they have to accept the status quo. In fact, a long position likely increases their ability to influence changes and improve long-term performance.

[1] "Passive investors are good corporate stewards", Financial Times, January 19, 2016

As F. William McNabb III, Chairman and CEO of the Vanguard Funds has said, “We’re going to hold your stock when you hit your quarterly earnings target. And we’ll hold it when you don’t. We’re going to hold your stock if we like you. And if we don’t. We’re going to hold your stock when everyone else is piling in. And when everyone else is running for the exits. That is precisely why we care so much about good governance.”

Institutional investors are directing more resources, time and money, into building internal governance teams and actively engaging the companies they own in the belief that high standards of corporate governance and transparency in reporting can help create value. BlackRock, Vanguard and State Street have significantly grown their corporate governance teams. BlackRock for example now has the largest team with 31 people dedicated to governance and Vanguard has doubled its headcount to 20 over the last three years. In addition, Vanguard and State Street are reportedly poised for more growth in their governance department this year.

This year investors were explicit in their view that they expect companies to talk to them about changes on issues like environment and social policies that will impact long-term shareholders. State Street, for example, was explicit in their view that they expect companies to talk to them about ESG risks. Although it is true a lot of investors have had policies like this for a number of years, they were still willing to go along with management for the most part. For example, where previously Vanguard would abstain from voting on ESG proposals, its policy is now to vote case-by-case and it is pushing for greater environmental disclosure by issuers.

Setting the Agenda Without Casting a Vote

It’s not just through their votes that passive investors have been directing the agenda. Even before a vote is cast the disclosure of an institutions’ proxy voting guidelines can serve to influence change as issuers seek to meet their expectations rather than risk a vote against.

For example, BlackRock has made climate risk disclosure an engagement priority for 2017-18 which may serve as an early warning for issuers on the topic, especially given the typical size of a BlackRock position in an issuer. As a result, we have seen more companies focusing in improving their disclosure in these areas.

The model of “corporate access” has seen some inversion. In the past, institutional investors grappled to gain access to issuers in order to communicate concerns. With strengthened policies and governance teams, more and more issuers are now scrambling to understand the shareholder.

Public declarations, such as letters or high profile speeches by the likes of State Street and BlackRock have served to put issues like long-termism, corporate responsibility, and diversity on the top of issuers’ minds. State Street, for example, indicated in March with a statue of a little girl standing up to Wall Street’s famous bronze bull that it will start voting against nominating committee members who don’t make a verifiable attempt to improve female representation on their boards. While this move may have come back to haunt them a bit with the more recent disclosure of a $5 million settlement stemming from allegations it paid female employees less than their male counterparts, the lesson remains the same – issuers must consider major institutional initiatives like these or potentially suffer the consequences at the ballot box.

Impact of Institutional Activism

Academic research has found that an increase in passive ownership influences a company’s governance choices seeing an increased passive position associated with more independent directors, the removal of poison pills, fewer dual-class share structures and more support for shareholder-initiated shareholder proposals.[2]

For companies, a withhold vote can serve to notify them they are on a short leash and changes are needed. Reviewing the policies of shareholders, not just the proxy advisors, can help mitigate voting risk and ensure companies are on the forefront of governance best practices.

For the investors, the exercise of voting their views sends a signal across their portfolio to all companies, especially the smaller ones. If an investor like Blackrock votes against a mega-cap company, it serves as a warning to all companies in their portfolio that they need to be on top of the issues that triggered the withhold vote. Companies considered standard setters need to be especially aware of the active passive investor.

With the traditional lines between investment categories blurred, companies can no longer can assume their traditionally quiet investors will meekly go along with management.

[2] “Passive Investors, Not Passive Owners”, Ian R. Appel, Todd A. Gormley, and Donald B. Keim, Dec. 18, 2014

Governance Concerns

Many investors have voiced their concerns about dual-class companies, with some large institutional investors, such as CalPERS, refusing to invest in IPOs with dual-class stock.

Concerns include the fact there is a disproportionate amount of economic risk for subordinate shareholders and that super-voting shareholders can elect or replace board members, resulting in passive boards or entrenched management teams that face limited repercussions for their decisions.

With such a lack of oversight often found in corporate scandals, there are also concerns surrounding the ease with which one could misappropriate company funds with the controlling executive shareholders' ability to withdraw funds and assets from the company via excessive compensation, self-serving transactions, or cash flow being diverted away from the business towards unrelated management projects, as well as inadequate succession planning. Fundamentally one has to question which is the more pressing motivator – to preserve the status quo or to generate superior returns for subordinate shareholders? This can be even more pronounced for a corporation pivoting from growth stage to mature "cash cow" stage when both the excitement and stock appreciation are waning.

View of Proxy Advisors

ISS believes that the fundamental tenet of shareholder democracy is the "one share, one vote" principle. Naturally, the very thought of dual-class stock is counter to this. ISS would generally vote against the creation of a new class of common stock unless the new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; the new class is not designed to preserve or increase the voting power of an insider or significant shareholder; and the company has disclosed a compelling rationale such as: the company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or the new class of shares will be transitory. In the case of a company controlled through a dual-class share structure, the support of a majority of the minority shareholders would equate to majority support under their board responsiveness policy. Glass Lewis, on the other hand, generally recommends shareholders support measures that would curb the disparity between economic and voting rights at public companies. Interestingly, when multiple class share structures are collapsed, this may also be a point of entry for activists or contentious situations.

Considerations for Companies and Best Practices

For companies who have listed with multiple-voting classes and are experiencing criticism, the introduction of sunset clauses; coattail provisions for change of control transactions; a maximum voting ratio of multiple-voting shares to subordinate voting shares; the use of strongly independent and unrelated board committees; and the elimination of any premium paid to multiple-voting shares should the dual-class structure be collapsed, can serve to mitigate some shareholder concerns.

For subordinate shareholders, there does not appear to be a practical way out. Shareholders understood what they were buying so it is hard to force change – a fact that courts have pointed out when rejecting oppression cases. Perhaps a way forward is to only allow for professional investors to take positions in dual-class companies given the limitations on the rights of the subordinate shareholder

RECOMMENDATIONS

section

03.

EVOLVING ROLE OF PROXY ADVISORS

The role of proxy advisors, most notably Institutional Shareholder Services and Glass Lewis, is constantly evolving. In this year's proxy season, we saw ISS and Glass Lewis tighten their policies and their application, which impacted the outcome of not only contested meetings, but of standard annual and special meetings

A mistake issuers make is thinking that what led to a positive recommendation last year, or even earlier in the current proxy season, will undoubtedly lead to the same outcome the next time around. This is not the case and you shouldn't have to see your vote fail to know the goalposts have moved and guidelines will continue to evolve.

For companies to position themselves optimally in the eyes of the proxy advisors and to secure a positive recommendation, it is essential they have an in-depth understanding of how proxy advisors will view a proposed transaction, slate of directors, or other proxy proposals. Issuers need to get inside their heads and think like a proxy advisor. This is not easy, which is why an experienced, leading-edge strategic governance advisor is crucial when it comes to navigating the complex waters of ISS and Glass Lewis. A seemingly routine vote or deal can be completely derailed if the issuer doesn't have a thorough understanding of the nuances and considerations that go into the decision-making process.

Why are Proxy Advisors Tightening Their Policies?

As subscribers to ISS and Glass Lewis it is the large shareholders who help set the agenda; their needs and attitudes help to craft policies and how they are applied. As the expectations of shareholders change, so do the policies of the proxy advisors. For example, the introduction of ISS' Equity Plan Scorecard methodology is meant to reflect the increasingly diverse metrics institutions are using to evaluate equity plan proposals. Recall in the past ISS primarily focused on only the cost of the plan.

Even if there is no formal policy in place, we know that having a proxy advisor subscriber coming out and publicly raising concerns about an issue can influence the proxy advisors to at least dig deeper or take a second look.

It is worth noting that on some contentious issues, the proxy voting guidelines of certain institutional investors may be even more stringent, using the issues identified by the proxy advisors as “red flags” that require additional probing. For example, take equity plans. Even though an equity plan may be structured to satisfy the guidelines of ISS, institutions may vote against it after conducting their own analysis and taking a harder line on elements such as burn rate, dilution, plan cost, change of control, or the evergreen reserve feature.

Why the Proxy Advisors Will Continue to Gain Power

While the retail investor is unlikely ever to become extinct, signs indicate they are on their way to becoming an endangered species. It used to be that a typical issuer could count on its shareholder base to be made up of approximately half institutional investors and half retail investors. Today, a new generation of investors no longer invests in individual stocks for the long-term, rather opting for mutual funds, index funds, or ETFs.

With mutual funds and ETF investors like BlackRock, State Street, Vanguard, Fidelity, Norges and others now control trillions of dollars of investments, they, along with large pension funds and hedge funds, are eclipsing the retail investors, particularly in newer public companies. As subscribers to ISS and Glass Lewis, and the conduit for their vote recommendations, we can see how the importance of the proxy advisors' vote recommendation is quickly being magnified.

How Companies Can Prepare

Start with the end in mind. Know how proxy advisors will look at your situation and keep that paramount as you design your resolution or deal. Management needs to spend time with governance advisors who know how the proxy advisors think to prepare. A big part of this means understanding that the public policies of the proxy advisors are only the part of their evaluation. On virtually every recommendation a qualitative assessment and human factor play a role.

A good advisor will tell you what the recommendation and resulting vote will be and what you can do about it. Companies should start by completing a risk assessment of how shareholders will react to proxy advisors' recommendations and the vote impact. As much as this will influence the design of your proxy statement, more importantly it will influence your overall strategy. For example, in a proxy fight what tactics do ISS and Glass Lewis frown upon? In M&A what do they like to see in terms of strategic rationale, negotiation, and transaction process? Will they go beyond the deal and look at go-it-alone scenarios? Will they do their own work on the acquirer's pro forma financing? These are important questions upfront because it will be difficult to go back and revisit once you realize the proxy advisors have an issue.

In instances where negative recommendations are predicted, shareholder engagement should occur right away. From our experience, every shareholder is unique: the policies, stance, and the personalities of those actually casting the vote, be it the portfolio manager or the governance specialist, are all different. The one who made the decision to buy your stock may not be the one casting the vote. While the investment team and portfolio managers may help, governance specialists at institutional investors are key influencers on proxy voting matters.

It is worth noting the rise of in-house governance teams at institutional investors has created a new paradigm for issuers and requires an extra layer of strategic design when considering proxy items. Additionally, some shareholders subscribe to one or more proxy advisors, but don't necessarily follow their recommendations strictly. If there does happen to be a negative recommendation, all is not lost, but how you respond and position yourself following the recommendation is crucial.

For all the time and effort boards and management put into designing and de-risking proxy items or transactions, doesn't it make sense to make sure proxy advisors don't have the opportunity to derail your vote?

NO SUCH THING AS A FRIENDLY DEAL

The days of the straightforward friendly deal are over. Even the most seemingly routine M&A transaction now comes with an increased set of risks. The fact is a friendly deal can no longer be counted on as a "sure thing." Activists who specialize in 'bumpitrage' and long-term shareholders not happy about a deal's valuation have had a significant impact over the last few years. When you consider the time, money, and effort that goes into just getting to the announcement of a transaction, doesn't it make sense to understand, consider, and prepare for those – from activists to your own shareholders to the proxy advisors – who could derail your deal?

How Activists Plan to Impose Themselves on Your Deal

Picture this. You've just spent nine months conducting due diligence, pouring through mountains of corporate data and financial models, preparing to make a takeover offer. Your A-team of advisors is lined up, you've secured financing and your offer is ready to go. After a few rounds of friendly discussions, the time has finally come – you've negotiated a merger between your company and a sought-after competitor. The finish line is in sight and all you need are a few more industry checkmarks and shareholders to support your view of the future combined company.

Now fast-forward to your joint-deal announcement — the premium offered is high relative to historical trading and first reports from the analyst community are positive. Your long-term shareholders seem to like the deal and things could not be going better. But wait, two weeks later an activist press releases that your sought-after deal isn't so great after all and not only do they want more — their support group of your shareholders does too.

What was once a simple cog in the transaction wheel has become one of the most difficult components in the M&A process.

While public activist campaigns continue their downward trend in 2017, we have seen an increase in shareholder intervention in transactional matters in 2016 and activism as a means to spur or oppose M&A

Is This Sabotage? No, It's Bumpitrage

Bumpitrage, a form of event-driven arbitrage, occurs when an activist investor purchases shares in a target company for the sole purpose of blocking or manipulating the vote/tender process to push for a higher price.

These investors see themselves as real-time matchmakers who work with all parties involved to get a solution. In their eyes, it's simple. Every buyer wants to buy something at the lowest price they can get and it's their job to make sure they pay as much as possible. Of 69 opposed mergers since 2013, 19 ended up increasing their offers to appease these shareholders with an average increase of 21% in North America.

How Do Bumpitrage Artists Pick a Target?

Surprisingly, the process of picking a target is not as complex as you might think. On the day of your deal announcement, the activist begins running various work streams with analysts creating internal merger models comparing the deal's valuation to public trading valuations of peers. Precedent deals, peer performance, asset intrinsic value, and going concern value are the most important metrics. In essence, they are gut checking the work your bankers did to structure the deal.

How you've structured your deal will play a critical role in their analysis. Necessary government approvals are also considered vis-a-vis timing and success. On a

TOP 10 LIST TO BLOCK A TRANSACTION

01. Run merger model with peer performance analysis

02. Analyze deal terms (length, approvals, etc.)

03. Talk to industry peers, experts, thought-leaders on their views of the industry

04. Define strategy for putting pressure on issuer (i.e. come out early and loud, wait for certain approval hurdles to be cleared before voicing concerns)

05. Identify shareholders – call/ meet with top 5-10 and gather their thoughts

06. Accumulate blocking position or partner with likeminded shareholders

7. Contact company – CEO, CFO, IR to drill down on details of the offer

8. Establish yourself as an expert and build credibility with target/ seller – have to cast a shadow of doubt across all parties.

9. Run aggressive PR campaign against the deal

10. Negotiate better deal or alternate beneficial outcome

parallel stream, the activist begins calling and meeting with your largest shareholders to enquire about their views of the deal and start sowing the seeds of discontent. Are they happy with the process? What was their original investment thesis and does this arrangement satisfy their needs? Could they support another structure?

The results from these calls and meetings will dictate whether the activist inevitably pushes ahead with their blockade because they can't do this alone. While small-cap 'bumpitrage' provides the opportunity for these funds to pick up a large and influential stake relatively easily, targeting large-cap companies requires marshalling support from other investors to secure a blocking position.

Historically, the next step was simple. Look for a large credible institution that would be interested in being the public voice. The frontman. A long-term shareholder that will exude credibility in the eyes of the proxy advisors who favor the long-term/constructivist style to the short-term event-driven strategies. Ideally, this is someone who can stand up and say that they've owned the stock for ten years and while they like management, they don't like the deal.

However, what we are increasingly seeing today is the rise of the 'RFA' or 'request for activism' as long-term traditional money managers look for activists and event-driven funds to take on the role of the agitator. Though they may not like the deal privately, their public image is important and having an activist do the "dirty" work helps them save face. Neuberger Burman, a long-time steward of pension funds and retirees, approached multiple hedge funds this year after their conversations with Whole Foods went stale to put pressure on the company. Weeks later, JANA Partners announced itself as second largest shareholder of Whole Foods pushing for and ultimately achieving sale of the company.t

The Role of Proxy Advisors in M&A

In a merger, the battle for ISS and Glass Lewis support is always fought well before the advisory reports are issued. Activists know this. They reach out to your larger shareholders who pay for their recommendations and have them call ISS and Glass Lewis directly to talk about why they don't like the deal.

While a credible long-term institution like a Blackrock or Fidelity may not be open to publicly supporting the activist, they might be more willing to pitch their view directly to ISS and Glass Lewis. From the activist perspective, this can make a difference. Since 2014, ISS has more than doubled the number of M&A transactions it has recommended against. Glass Lewis has been more aggressive historically in terms of recommending against M&A transactions compared to ISS. There may be a couple of reasons for this. The first may be due to the overall increase in M&A shareholder activism. The more transactions that are subject to activist attack, the higher the likelihood ISS and Glass Lewis will apply heightened scrutiny, thereby triggering an increased likelihood they will recommend against the transaction.

The second may be the reflection of the expectations of their institutional clients. There has been an increasing trend of institutions who have adopted a case-by-case approach in evaluating M&A transactions. This could require ISS and Glass Lewis to produce more in-depth and higher quality analysis for transactions, as opposed to applying black-and-white policy guideline approach on routine governance items. In addition, what companies sometimes don't appreciate is that an ISS or Glass Lewis client might call or email feedback on a deal to the proxy advisor, and that will be sufficient for them to take a deeper look.

It is worth noting that ISS and Glass Lewis may not put too much weight on fairness opinions disclosed in the proxy statements or in most cases, just use them for a sanity check in an uncontested analysis. If warranted, they will conduct their own valuation analysis. Also, proxy advisors place emphasis on the transaction process: the time taken, the number of financial advisors retained, potential buyers spoken to, etc.

What Boards Can Do

A number of steps can be taken to ensure deals are more resilient. As the deal is announced, boards should recognize how fast things will move. The announcement is just the start, not the end, of your campaign. Third parties are prepared to criticize the terms of the deal faster than ever before.

Know your shareholder base and the valuations they put on your business. Without a larger institutional shareholder supporting them, activist investors will be hard pressed to derail your deal. Shareholder engagement is imperative to understanding the thesis of your investors and the targets they have; if the deal doesn't reach their valuation target, it is likely they will vote in support of the activists. Build relationships with the investors that matter and continually maintain dialogue. Activist investors are sophisticated and as their credibility continues to strengthen, so does the effect of their message on fundamental shareholders.

Voting lock-ups are one possible tool. If they are not feasible, acknowledging the challenge of selective disclosure, talk to the shareholders most likely to have reservations early and often, especially if their opinions are influential. Planning a merger with Dow Chemical, DuPont did just that, inviting Trian Partners to comment on the structure of the deal privately. At the end of the day, a bidder having lock-ups, even if 'soft', can be a crucial element of the deal.

If an activist emerges, the board should immediately activate its already developed contingency plan as well as a communication plan. Consideration of next steps should focus on the activist's critiques and expected traction they will find with shareholders. Management then must consider the expectations of the activist. For instance, if the premium is 30% and the activist wants a 45% premium.

Activists might also press for a standalone process, yet management might have its reasons for wanting to accept an offer. For example, if a business is in the midst of a difficult turnaround, show the activist the facts and ask their advice on how to approach the turnaround. Perception may be different from reality. Explaining the downside risk and liquidity advantages of staying independent can help.

CHECKLIST FOR 'FRIENDLY' DEALS

As one activist who recently derailed a transaction remarked, "Process will protect you from the courts but not from shareholders." A holistic approach is required that considers advanced planning and issues that may emerge after your deal is announced – yet can be proactively addressed. Here is a top ten list to help boards prepare.

01. Prepare for an activist by viewing the deal through shareholders' eyes, looking for weaknesses

02. Monitor trading activity prior to the deal, considering how the deal impacts on the goals of buyers

03. Take the temperature of your shareholders as soon as a deal is announced

04. If an activist does emerge, understand how their objective will resonate with other shareholders

05. Consider a settlement or confidentiality agreement, but be prepared to say no

06. Emphasize the robustness of the strategic review process in your proxy statement

07. Explain the strategy and downside risk to other courses of action

08. Prepare to engage with proxy advisors, provide solid backup for valuation assumptions

09. Equity analysts carry more weight than your financial advisor

10. No deal is safe – be able to "show and tell" how and why it is a good deal

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