

Q&A with Steven B. Stokdyk & James D. C. Barrall

## WHAT TO EXPECT IN THE REMAINDER OF THE 2015 PROXY SEASON

August 10, 2015

In this lw.com interview Latham & Watkins partners Steven Stokdyk and Jim Barrall discuss shareholder proponent types, director voter results, proxy puts and other 2015 shareholder activism trends. “There are victories in dealing with shareholder activists, and if companies do take proactive action and are able to clearly articulate their strategy and why their director should be supported, it is still possible for companies to have a lot of success in this area,” says Stokdyk.

### What are the types of shareholder proponents?

**Stokdyk:** Shareholder proponents fall into three different categories — activists, funds with social agendas and corporate gadflies. We haven’t observed a correlation between the types of proponents versus the outcome of the issue that is the subject of their shareholder proposal, or whether the nature of the proponent affects the credibility of the proposal for other investors. For the major themes and issues we are discussing today, the nature of the proponent doesn’t seem to have an effect.

I want to note that some of the union funds have been targeting industries that have been more heavily unionized. Recently, a union pension fund made a large number of proposals to companies in the lodging industry, and they used their own dissident proxy card for the actual proposal itself. We see that regularly in terms of elections for directors and in contests for directors’ elections. We’ve rarely seen it in the context of shareholder proposals. I think we’ll start seeing more of the well-funded proponents use tactics like this that will cost them more money but obviously bring more attention to their proposals, and may potentially lead to more success on the issues that they are pushing for.

### What can we learn from director vote results?

**Stokdyk:** The results show that there still is a lot of success for existing directors. Ninety-six percent has been the average support for directors getting reelected, and those that have failed to get majority support have numbers in the low double digits. Within the 3,000 companies surveyed, this is an incredibly small number.

There are many issues that investors are looking at when they’re considering whether to vote for directors. One issue that could be bigger going forward, which we hear a lot of talk about among investors, is a focus on disclosure of director compensation and executive compensation. In the proxy context, it always used to be a wedge issue, but I think it’s going to become more of a central issue, in terms of proponents who are trying to get their own slate elected or make other changes at the company focusing on problems with compensation.

### What have been the concerns with debt change of control provisions, also known as Proxy Puts?

**Stokdyk:** Recently, there have been a number of litigations and shareholder demands relating to Proxy Puts, which are provisions in credit agreements that provide if there’s an event of default or a change in the board of directors who are not appointed by the existing directors. Its real purpose is for lenders to know who is in control of their company and that there’s an orderly succession, and not have the entire board swapped out — banks would want to revisit who their borrower is at that point. So there’s a very valid business reason for including these provisions.

A small minority of provisions is referred to as the Dead Hand Proxy Put. In most of the Proxy Put language, if you

have a dissident slate being elected, the existing board can approve that dissident slate and it doesn't cause an event of control. Some provisions don't allow the existing board to take that action, which would automatically lead to a Proxy Put, which could lead to the debt being accelerated. There are claims that this has a deterrent effect for electing new directors. In fact, there are also claims that it could be a breach of fiduciary duty on the board for including these provisions in their debt. The focus now is on debt agreements, but it could be any significant commercial agreement if they have not carefully considered when they enter into those agreements the implications of those on proxy contest.

We're spending a lot of time with companies focusing on the adoption and negotiation process, which is the board process for considering these issues and the implications. We've seen many different reactions from banks as a result. In fact, some of them were brought into aiding and abetting lawsuits. Those have, by and large, gone away, unless there is an allegation that what they're seeking with these provisions that is not in their own interest, i.e., with a bad motive, to basically help the company entrench management, as opposed to a valid commercial reason.

### Has there been an increase in shareholder activism?

**Stokdyk:** It is definitely becoming more mainstream. There are hundreds of situations going on right now — a lot of time, effort, articles and resources are dedicated to this area. Some institutional investors are also somewhat supporting some activism ambassadors, either overtly or behind the scenes. The US Securities and Exchange Commission (SEC) has weighed in that they're going to be focused during these campaigns on compliance with law on both the investor side and the company side, in terms of appropriate disclosure as well as following the proxy rules. They've also indicated that they might be reviewing wolf-pack actions of ambassadors at some point in the future, but we're not sure when or what form that's going to take.

So we're constantly encouraging boards to be well prepared for these types of situations, analyze their weaknesses and lines of attack, and review their corporate governance, as well as focus on compensation for all the disclosures.

In one case, however, a company was able to emphasize the different successes it has had over the years with its existing directors and clearly articulate its strategy going forward. The institutional investors bought in to the company side of the story, and were not convinced that the shareholder activists would bring anything to the table, even if it was only a minority slate. So there is good news for companies: there are victories, and if companies do take proactive action and are able to clearly articulate their strategy and why their director should be supported, it is still possible for companies to have a lot of success in this area.

### If action is taken this fall, when are we likely to see the rules proposed by Dodd-Frank take effect?

**Barrall:** There is no requirement in the statutes or the rules that require a delayed effective date. So if the SEC, in fact, promulgates final rules on hedging, CEO pay ratios or pay versus performance this year, it could accelerate the process and have them take effect for the 2016 proxy season, even if the rules are not finalized until late in the year. I would not be surprised if one or more of these rules are in effect for 2016. But we'll see these rules play out and should know more about likely effective dates by the end of this summer or fall.

### For More Information

For more information on the 2015 proxy season and the prospects for the balance of 2015, register and listen to the pre-recorded webcast titled "[2015 Proxy Season: Lessons Learned and Coming Attractions](#)." This presentation will be available to audience members until Wednesday, June 15, 2016 at 11:30 AM Pacific Daylight Time.

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