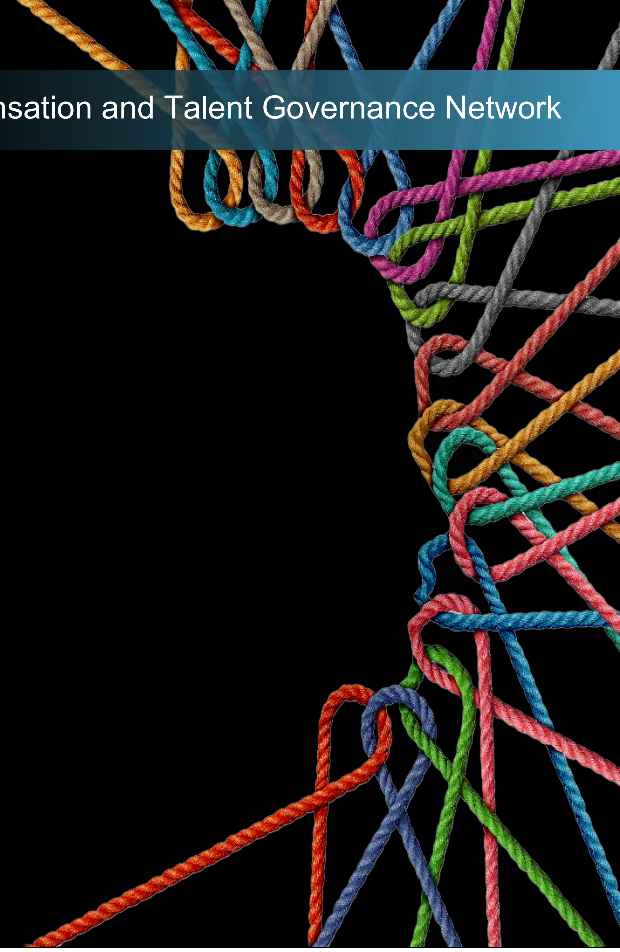

CTGN SUMMARY OF THEMES

Shareholder activism and the 2024 proxy season

May 2024

As it enters its third generation, the level of shareholder activism remains high, with a third of all campaigns now led by first-time activists who are deploying new approaches to scrutinizing governance, performance, and strategy. Boards face the need to stay informed about activists' objectives and the triggers for their involvement, and to be prepared to respond to potential activist interventions.

On May 14, 2024, members of the Compensation and Talent Governance Network (CTGN) met virtually to discuss shareholder activism, including current trends in the activist landscape and the role of compensation in activist campaigns, board preparedness, and strategies for addressing activist interventions. Members shared experiences and outcomes from recent cases.

Members were joined by Rich Thomas, Managing Director in Lazard's capital markets advisory group, and Virginia Rhodes, partner, and Ed Hauder, principal and head of research and content, at Meridian Compensation Partners.

For a list of meeting participants, see page 6.

This *Summary of Themes*[1] covers key themes that emerged during the conversations:

Navigating today's activist landscape

Preparing for an activist intervention

Responding to an activist campaign

Assessing the 2024 proxy season

Navigating today's activist landscape

As companies contend with a multiyear surge in shareholder activist campaigns, it becomes crucial for boards to remain abreast of the evolving activist landscape. Members and guests discussed recent trends, including the following:

- **The emergence of first-time players.** An influx of new, often smaller funds has broadened the activist landscape. Mr. Thomas said, *"We have more first-time activists joining the fray, making up a third of all campaigns; it's not just about those top names. Many of the new activists were portfolio managers at those well-known funds, and now they are saying, 'We can start our own fund' and they recognize that they don't need $60 billion in assets. They can do a lot with $1–$2 billion."*
- **A shift in activist focus from mergers and acquisitions (M&A) to capital allocation.** After a surge in M&A-related activism last year, activists are focusing more on capital allocation, in part because of shifting expectations around the direction of interest rates. Mr. Thomas said, *"A lot of activists last year had the impression that by this time, we would be on a rate-reduction trajectory, but that hasn't happened, and many of those M&A campaigns have started to dry up."* He added, *"Some companies are struggling to drive total shareholder return and it's also very difficult right now for them to sell themselves, so activists are urging companies to rethink their strategy and priorities and ensure that dollars are being spent in a manner that will create the most value."*
- **Increasing personal attacks on directors.** Activist funds are increasingly targeting individual directors, scrutinizing their professional and personal histories for information that can undermine their credibility. *"Not just in proxy fights but even on regular campaigns, they are looking closely at directors' historical track record. Now, every time we go through director recruiting and vulnerability assessment, we're looking at every single role that director has had in an executive or board capacity to understand where they have, or have not, created value,"* said Mr. Thomas. Activists are using specialized research firms to find embarrassing information, sometimes by paying former employees for information under the guise of doing market research. *"This is an area of the activism universe that has gotten a lot more developed, with new research organizations offering their services to investors."* Attacks can include personal and seemingly private information.
- **Compensation as a lever in activist campaigns.** While activists rarely launch a campaign specifically to address executive compensation or dissatisfaction with incentive plans, they often use these issues to attack the board and call into question its ability to effectively fulfill its responsibilities. Mr. Hauder said, *"They're trying to use compensation as a wedge and an embarrassment factor to point to the board as failing to do their job. It is adjacent to the real issues, and it's going to tie up*

management and the board trying to defend themselves against it." He emphasized that activists take a backward-looking approach, tracking compensation against past company performance, particularly share price. *"If they see some type of mismatch, that's when they're going to look deeper into your compensation, and they're going to look to see if there's things they can pull out and use in the campaign,"* he cautioned.

- **Vulnerabilities around CEO transitions.** Activists can use a poorly managed CEO succession to argue that the board is failing at one of its major responsibilities. One member noted that in an activist campaign they had faced, *"the real issue was a failed CEO succession*," acknowledging that *"to champion that is our number-one responsibility, and that's what we're accountable for."* Members agreed that CEO succession planning should be an ongoing explicit discussion on the agenda of almost every board meeting. *"It is by far the most important thing we do,"* a member said. Mr. Thomas also pointed out that new CEOs are more likely to face an activist campaign, while the presence of an activist often accelerates CEO turnover. *"With new CEOs, the likelihood of facing activist attacks doubles in the first six months of their taking office. It is imperative for boards to always maintain a robust activist plan, but especially during CEO transitions. Once a company is targeted by an activist launching a campaign, the risk of CEO being removed or stepping down more than doubles in the next 12 months,"* he said.

Preparing for an activist intervention

Members and guests emphasized the need for boards and compensation committees to be prepared for shareholder activism and identified several key strategies for staying ahead of an activist intervention:

- **Stay close to the investor base.** One member said, *"It's important for the board to have relationships with major investors so when problems arise, it's not the first time you're talking to them. When it came time to talk to investors during an activist campaign, we already had relationships with them."* Mr. Thomas urged members to develop strategies to gain a clear, unfiltered understanding of shareholder perspectives on the company, such as facilitating direct discussions between major shareholders and the board (without management present) or formally surveying the investor base. He said, *"The idea is that you want to hear from someone who's going to tell you what you need to hear."*

- **Design a robust communication plan.** Members noted that activist campaigns play out in public, making it important for companies to effectively communicate to a broad audience. Mr. Thomas encouraged management teams to have a proactive media strategy that helps to shape public perceptions before and during activist involvement. *"Companies are not getting ahead of the news messages. The narrative around a campaign is often shaped in the media, before direct* *communication with shareholders occurs, influencing their perceptions of the company."* He also stressed that board members should ensure that management is prepared to engage with the press regularly and respond quickly to any questions that arise: *"The company has to be front-footed with getting the message out and have talking points ready to go for the press."* While board members typically should not be responding publicly to an activist, the board may need to respond directly when it is being attacked. In those cases, Mr. Thomas said, *"The board needs to speak as a single voice. We don't want to have individual directors going out and starting to defend themselves."*

- **Audit the company's compensation plans.** Mr. Hauder encouraged compensation committees to examine their compensation plans and payouts in detail, attempting to view them through the lens of an activist. *"Look thoroughly at how the plans are designed. Is the design typical or should anything be flagged?"* he said. In addition to asking the basic question of *"how does our pay look relative to shareholder returns?"* he identified some specific aspects of compensation plans that an activist might use in a campaign, such as a high ratio of CEO pay to that of other named executive officers; elements of plans that differ from peers, such as using different targets or different equity compensation vehicles; using an *"aspirational"* peer group in establishing pay ranges; and targeting pay at high percentiles of the relevant peer group. It may not be necessary to eliminate such features of compensation plans, Mr. Hauder said, but *"committees should have a concrete rationale for why anything out of the ordinary is in your plans and be ready to discuss that with everyone, especially activists."* Auditing pay plans in this way can also surface broader issues around the public perception of executive compensation that go beyond concerns about activists. For example, one member noted, *"If you're a company with a large retail shareholder base and a visible brand, your CEO pay can't be really high, because that hurts the brand integrity of the company."*

Responding to an activist campaign

Activist campaigns create a major distraction and demand significant time and effort from both the board and management. One director noted a case where there were more than 100 calls between the activist and the management team in the early stages of an activist intervention.

Once a proxy fight is under way, the board has a crucial role to play. A director said, *"We tried to protect management as much as possible by engaging with investors, assigning specific tasks, and reassigning responsibilities to allow some people to focus on business as usual."* This can include identifying select senior leaders to work with the CEO and the board in spearheading the response to an activist, leaving business leaders free to focus on day-to-day execution. A member said, *"We had a proxy team assembled already, with an internal team of the chief financial officer, general counsel,* *head of investor relations, head of corporate communications, and a group of external advisers. So they weren't the line people driving the business; they were more the leaders of functional areas."*

Responding to an activist requires a significant time commitment from the board, which plays a leading role in engaging with key constituencies. *"It was an enormous time drain,"* one director recalled. *"We did 25 outreaches to investors and proxy advisers"*—all of which included multiple board members—*"and 15 of those were face-to-face*."

Members and guests advocated engaging with activists to seek compromise as much as possible. Mr. Hauder encouraged members to sit down and talk to an activist to better understand their concerns. *"It doesn't cost anything to truly listen,"* he said. *"What are investors truly after? Sometimes they're trying to get to something that they're not really presenting."* One member described significant efforts to accommodate an activist and head off a public proxy battle, including making the board and management team available for frequent dialogue and providing privileged access to company information to address strategic and operational concerns. *"We tried to figure out how to prevent it from happening,"* but, as is sometimes the case, it was impossible to reach a compromise. *"We gave the activist several off ramps, but they didn't take them. For them, it was board or bust, and we concluded that it would be disruptive to the business and destructive to the company"* to give them a seat on the board, the member explained.

Assessing the 2024 proxy season

Despite an upward trend in say-on-pay support this proxy season, companies continue to face scrutiny around pay, particularly the link between pay and performance. Ms. Rhodes noted that despite all the work that management teams put into enhanced disclosures around pay and performance, confusion persists among investors and proxy advisers. *"I do think investors are struggling to unpack the relationships that these disclosures are trying to show, even with the nice graphs that companies are including. And the proxy advisers really don't know what to do with the information yet,"* she said. Given the lack of clarity, Ms. Rhodes shared concerns that pay versus performance disclosures will receive diminished attention: *"I worry that this is going to be one of those things that gets shoved further and further back in the proxy statement and doesn't get a whole lot of attention."*

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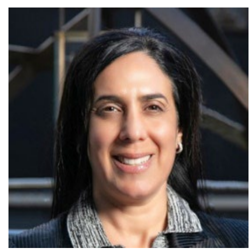

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Endnotes

[1] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.