

# Article Reprint

STAY TUNED..

## Proxy Season

## Matters...

## Really Matters to the IRO!

**BY HANK BOERNER**

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# STAY TUNED... PROXY SEASON MATTERS... REALLY MATTERS TO THE IRO!

**BY HANK BOERNER**

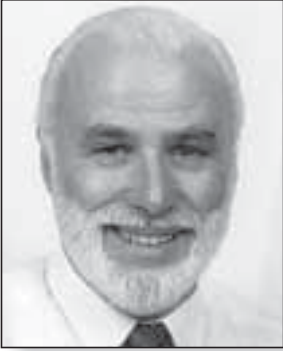
Spring is here and the annual proxy season is in full gear — and why does this matter to the investor relations officer? The dramatic changes taking place in recent proxy seasons — and the sea changes to come in 2007 and 2008 — could change the basic nature of investor relations and directly impact the role of the IRO. This may be a bold prediction, but just look at the power players now engaged in your company's proxy campaigns — not just in proxy season, but increasingly, year-round — and how their concerns are reshaping shareowner-corporate relations and communications.

Consider the long journey bringing us to proxy season 2007: The modern corporation is a very complex web of interconnected and often competing interests. The start of the enterprise was probably straightforward: founders used their own funds and/or offered partial ownership to early providers of capital; after the initial public offering a broader and more diverse base of owners resulted and complexity quickly set in. The disparate base of shareowners elected representatives to look after their

interests — the board of directors, most elected annually in proxy votes. Directors as part of their duties recruit and appoint senior managers whom they then monitor and hold accountable. We might consider hiring and firing the CEO among the board's most important duties to shareowners.

There are many other duties of the board, but investors are now intensely focusing now on the “who,” “how” and “what” of director stewardship. Director elections are primary opinion-shaping arenas for activist investors. The dominant form of electing directors has been the *plurality* system — directors being voted into office with just one share vote cast (could be their own), unless another candidate opposed them. Getting an opponent on the ballot is a Herculean task for shareowners — which means that until now it has been very difficult for shareowners to vote someone *off the board* or *deny* the candidate his or her board seat. That is changing — and the changes will impact you.

The California Public Employees' Retirement System began a major campaign in March 2005 to change corporate electoral



Hank Boerner

practices, calling on companies to voluntarily change their bylaws or charters to implement majority voting; if that won't work, CalPERS called on the SEC and major stock exchanges to implement majority voting. The trigger for this action was the 2004 proxy season, in which 16 directors at nine companies did not get 50 percent of votes cast, raising the ire of institutional activists like CalPERS.

Other investors have joined the parade. Issues surrounding proxy voting complicate shareowner-board, shareowner-manager and board-manager relations. Annual proxy seasons have moved from being mundane and often ignored events to well-publicized and sometimes titanic struggles. These struggles pit directors (elected by shareowners) against shareowners, and C-suite execs seemingly against the interest of the owners of the enterprise. Complexity, indeed! Welcome to the modern corporate governance movement.

**Stay Tuned to...**current proxy season issues continue to flatten out linear style and become perennial and year-round, not just once yearly dramas. The focus on key issues for a growing number of investors is continuous; watch investor reaction to upcoming disclosure on CEO compensation and you'll see campaigns gearing up in 2007 for the 2008 proxy season. Directors ignore shareowners now at their own peril. The dust up at Home Depot at its last AGM — no directors were present — continues to ripple through the institutional investor community.

**Stay Tuned to...**the current corporate governance campaigns waged by activist investors. Here's your top-line 2007 agenda:

- **Demand for majority vote for directors.** The noises you hear, increasing in volume and more edgy in tone, are the voices of investors clamoring for adoption of majority voting for directors. The Council of Institutional Investors (CII) and the National Association of Corporate Directors (NACD) recently joined forces to issue governance recommendations to boards ("Looking Back, Looking Forward") which included allowing directors to be elected by a majority of those voting proxies.

- **Investors demand say in CEO and "C" suite compensation approval by boards.** Investors want their input to have an impact — a direct *yea* or *nay* on senior exec comp. Watch this trend. In February of this year, Aflac, a large supplemental health insurance provider, became the first U.S. company to offer its shareholders a say in how much executives get paid. An advisory vote on annual comp will begin with the 2009 proxy

vote. At least 50 U.S. companies have this "say-on-pay" resolution up for vote this year, says ISS. Said Aflac Chair Dan Amos: "Shareholders, as owners of the company, have the right to know how executive compensation works." In the United Kingdom, companies have had similar practices in place since 2002.

- **Separate Chair and CEO posts.** More investors are on board with this concept; the slowly unfolding drama related to board backdating of stock options could create real pressure to create separate posts, with CEOs the only executive board members reporting to full-time independent chairs. The revelations at Apple Computer Inc that senior managers may have falsified stock-option documents (Dow Jones, December 27, 2006) points to the need for more separation of board and management in important matters and more independence in board operations, such as approval of stock options.

- **Pressuring boards to change corporate strategies.** Breeden Partners (headed by former SEC Chairman Richard Breeden) bought five percent of Applebee's International (the restaurant chain) stock and demanded that the board cut spending, reduce the number of "owned" facilities and put four Breeden-nominated candidates on the board! Similar investor pressure at Home Depot following the departure of the CEO gave activist Relational Investors LLC a board seat for its prin-

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cial David Batchelder on February 22; he now sits on the HD Leadership Development and Compensation Committee, and the Audit Committee.

**Stay Tuned to...** more institutions (and more types of institutions) owning your shares, says The Conference Board in its January report ("Institutional Investment Report"). Year-end 2005 data show pension funds, insurance companies, banks, foundations and investment companies holding \$24.1 trillion assets in the largest 1,000 U.S. companies — 68 percent of all shares outstanding in these companies. Activist state and local pension funds own about 10 percent of U.S. equities and are increasingly wielding a bigger club in proxy voting.

Why does this matter to the IRO? The rise in institutions' share of U.S. equity markets means that the economic power and clout of American institutional investors — especially including activist labor, state and local pension funds — continues to grow, noted Dr. Carolyn Kay Brancato, Director Emeritus of the Conference Board's influential Governance Center and co-author of the report. "State and local fund investors tend to be the most vocal in demanding corporate governance reforms and will have a profound impact on companies in both the U.S. and global markets," she predicts, "especially as U.S. investors tend to be out in front of global shareholder activism."

**Stay Tuned to...** more of your traditional institutional investors also getting *more involved* in your proxy issues. Wall Street investment houses — including Deutsche Bank, Goldman Sachs, Merrill Lynch, and UBS — are signing on to the "2006 Carbon Disclosure Project," the global effort to nudge company boards and execs to disclose their carbon footprint, and by extension, make transparent the extent of the company's impact on global warming. There are 200 investment companies now involved in this effort, representing \$30 trillion in market assets. As institutions vote their shares, "social issues" on the proxy ballot are winning up to 30 percent support, triple the level just five years ago. These votes demonstrate the merging of traditional corporate governance issues with concerns of social investors.

**Stay Tuned to...** more money flowing into your shares from abroad, too. According to Dealogic, which provides tech platforms to major investment banks, Canada and France led the parade of foreign interests coming to buy U.S. corporate assets. Foreign companies invested \$219 billion in U.S. acquisitions in 2006 (57 percent increase over 2005) with Canadian companies investing \$45 billion and French firms \$38 billion. France's Alcatel SA acquired Lucent Technologies; the UK's National Grid acquired KeySpan Corp, and so on. As domestic public companies integrate with their foreign parent, part of buyouts will involve stock — and as U.S. institutions acquire portions of the acquirer, watch for export of U.S. institutional activism to the UK, France, Italy, Canada, and other countries. Shareowner-board,

shareowner-management relations will become more complex... and the complexity will certainly directly affect the U.S. IRO working for the foreign acquirer.

**Stay Tuned to...** continuing changes in board-shareowner and board-C suite affairs between the annual proxy seasons (from 2007 to 2008). TIAA-CREF's head of corporate governance, John Wilcox, writing in *Boards & Directors*, noted that in the months and years ahead majority voting and the right of shareholders to vote *against* directors will become the norm; separate chairs and CEOs will be more commonplace; "Imperial CEOs" will be replaced by more thoughtful and responsive *stewardship* models; sustainability and corporate social responsibility will become more mainstream corporate governance issues; proxy voting and shareholder communications will be more technology-driven, with new rules adopted by SEC. In time, he posited, the intense focus on proxy contents will give way to more year-round engagement on issues of concern to owners; both board and "C" executives will see that good corporate governance lowers capital costs, reduces risk and creates shareholder value over time. TIAA-CREF is the largest pension pool in the U.S., holding \$350 billion in market assets and is a leader in advocating sound CG principles. What T-C says on corporate governance matters to your company and to you!

**Stay Tuned to...** the role technology platforms will play in shareowner communications. Among the technology changes affecting proxy season 2008 and beyond are e-proxy distribution and voting. In December 2006 SEC approved voluntary publishing of corporate proxy statements and annual reports on line although investors must also have access to printed document delivery. The major shift to keep in mind is that your model changes from "opt-in" (an "e" request by recipient) to "affirmative opt-out," noted Commissioner Roel Campos. Company-shareowner communication will change even more dramatically as XBRL is implemented by public companies. The voluntary proxy e-filing can begin this July 1st; however, the SEC is considering mandatory publishing on the Internet for all of your "solicitations," such as proxy voting, maybe for the 2008 proxy season.

**Stay Tuned to...** finally, the prospect of your own involvement with board matters increasing. Think about it: as you look at the revolutionary changes taking place in shareowner-board relations, shouldn't the board be more involved with shareowners (who elect them in the first place)? Many experts say "yes." And what better resource within the company to help manage expectations and board-shareowner relationships than the investor relations officer? These "proxy matters" really do matter — to you! IRU

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*Hank Boerner is corporate governance columnist for NIRI IR Update. The views presented are his own. He welcomes questions, comments and views at [www.hankboerner.com](http://www.hankboerner.com)*