

## TRIAN TALKS PROXY PLUMBING AFTER PELTZ'S P&G WAR

Two top partners at the activist fund take a look down the 'snake pit' and found an opaque Kafkaesque bureaucracy that defines the proxy voting system in America.

BY RONALD OROL

In November, an inspector of elections responsible for tallying the votes in the largest boardroom battle in the history of director warfare revealed a surprising number: Activist Nelson Peltz was ahead of his rival at Procter & Gamble Co. (PG) by 0.0016% of the vote. Roughly a month later, P&G conceded and granted Peltz a seat even though the inspector's final tally, had the dissident behind by about 500,000 votes, still a minuscule number considering the near 2 billion - yes 2 billion - votes cast in the election.

In the interim, the vote tally fluctuated frequently as proxy solicitors and outside attorneys for both Peltz and P&G discovered an opaque Kafkaesque bureaucracy, full of over-voting, under-voting, chain of custody complications and a system where individual investors may not know definitively that their shares have been voted.

To help us navigate uncharted waters The Deal spoke with Trian Fund Management's chief legal officer, Brian Schorr, and senior analyst Josh Frank about lessons learned from the battle, which was also historic because of the incredibly close result. Schorr and Frank also offer up a roadmap for fixing a broken shareholder voting system. Blockchain anyone?

*The Deal: What did you learn from Trian's proxy contest with Procter & Gamble about our current proxy voting system? What are the top takeaways?*

**Brian Schorr:** We believe shareholders' ability to participate in director elections is fundamental to principles of shareholder democracy and is the primary mechanism by which shareholders hold corporate directors accountable. However, with a very close election like the P&G proxy contest, we found that it was very difficult to accurately verify the final results. That led us to step back and think about whether that difficulty of accurately verifying voting results creates a shadow over the concept of shareholder democracy.

Tell me a little about Trian's experience in the so-called snake pit as advisers for both sides were tasked in the P&G contest with examining about 2 billion votes cast, including physical cards and votes cast electronically.

Schorr: I would start with the premise that those in the "snake pit", Trian's and



Josh Frank, Brian Schorr, Nelson Peltz **TRIAN PARTNERS**

P&G's proxy solicitors and outside counsel, had a nearly impossible job. Nearly two billion shares were voted; in round numbers one billion shares for each side. In such a close election, every single share had the ability to be outcome determinative and the vote tabulation fluctuated as the review process went on during the multi-week process. In addition to having to go through approximately 100,000 individual cards, it was also necessary to review the chain of custody and other tabulation information that supported the votes of beneficial shareholders processed by Broadridge and other processing firms.

You also had to review reconciliations of over-voted shares. Over-voting can happen, for example, when securities intermediaries, brokers and custodians who hold the shares, lend shares, which they sometimes do for a fee. Only shares held by the custodian on the record date can be voted, so shares that are loaned out are not votable. The custodians have to reconcile how many shares they have on the record date with the shares owned by their clients. If a custodian receives voting instructions for more votes than it held on the record date and the custodian fails to cut back its clients' votes, an overvote occurs.

*Can the real owner, retail or institutional, really know definitively that their shares have been voted?*

Schorr: There is no way for the beneficial owner to know for sure that their shares have been voted. You've given voting instructions to your broker. You think you have voted "your" shares. But they could have been loaned out

without your knowing about it, thereby limiting your ability to vote your shares. Even worse, even if the custodian has the shares, there can be a break in the voting chain of authority between the voting intermediary like Broadridge, the custodian, any sub-custodians, and the company's registered list; which is completely invisible to the beneficial owner.

*What other problems can emerge?*

Schorr: There is the Depository Trust Company, the central securities depository and clearing house that transfers the power to vote shares that are in the record name of DTC's nominee Cede & Co., back to the banks and brokers that have deposited their shares with DTC. The banks and brokers distribute proxy materials and voting instruction forms to individual beneficial shareholders. Then the process reverses direction: the beneficial shareholder provides instructions to the bank or broker who actually votes the shares. In addition, beneficial shareholders can vote in person if they receive a legal proxy from their bank or broker. This has the potential to lead to issues relating to chain of custody [of votes] and last dated proxies.

*Unlike political elections, investors are given multiple opportunities to change their vote, as numerous potential new voting cards arrive at their homes. How did that complicate the review efforts?*

Schorr: Proxy cards and ballots must be properly signed and dated and only the last dated proxy is counted. Shareholders can change their vote up until the date of the election. Triana and P&G did more than a dozen mailings in the aggregate, so shareholders had many proxy cards to choose from and many opportunities to change their vote and submit later dated proxy cards. Some shareholders even changed their vote at the last minute while attending the annual meeting. As a result, issues arise over which card was the "last card" voted.

*One interesting area involves unallocated and uninstructed shares in a company's pension benefits plan. Seems like P&G was able to vote those shares in line with the way employees and retired employees voted, which probably was overwhelmingly against Nelson Peltz. Is that fair?*

Josh Frank: One area of concern involves unallocated or uninstructed shares in a company's pension/benefits plan. Shares are allocated to plan participants (retirees and employees), who then vote or direct the vote of shares that are allocated to them. However, in some plans, shares that have not yet been allocated to individuals and shares that aren't voted by plan participants are voted by plan trustees in the same proportion to the voting instructions received from the retiree/employee plan participants as to voting of allocated shares. Since the largest allocation of these shares and highest participation levels tend to come from senior levels of management, their votes are apt to disproportionately influence the outcome. We do not believe this is an equitable result.

*Knowing what you and P&G know today, how important is it for consideration to be given to changes to the so-called proxy plumbing system in the U.S.? Any specific recommendations?*

Schorr: SEC Chairman Jay Clayton said in November 2017 that the Commission

should consider reopening the comment file on its 2010 proxy plumbing concept release. We would support that. That process would likely allow for input from a broad range of constituencies. There are a number of questions that need to be asked. Most importantly, does the current proxy voting system operate with the accuracy, transparency and integrity expected by shareholders, issuers and other market participants? There are also many more technical issues to be studied, including over/under-voting and empty-voting and the broader question of whether there is a sufficient level of oversight over the proxy voting process.

*Would the collection and tabulation of votes be easier with a universal proxy card system, where institutional investors voting remotely would get more flexibility to pick and choose among dissident and incumbent director candidates on one card?*

Schorr: Triana submitted a comment letter in January 2017 on the SEC's universal proxy card proposal. In 1934, when the Securities Exchange Act was enacted, the legislative history made it clear that the proxy rules were designed to remove barriers to shareholder voting rights. We believe shareholders that vote by proxy should have the same choices that are available to shareholders that attend an annual meeting in person. Whether you are a Main Street investor or an institutional shareholder, a universal proxy card would ensure that shareholders who want to vote for a "split ticket" are not disenfranchised. Would a universal card be helpful in terms of the proxy plumbing problem? I would say that it has the potential to eliminate some of the confusion that results from having two competing proxy cards. It may reduce tabulation issues which arise when shareholders submit more than one proxy card.

Frank: It eliminates issues with respect to mixing and matching. In close contests some shareholders just get confused and frustrated. They may want to vote for the dissident and think the right way to do it is to write in their name on the company's proxy card, as they've seen in political elections. That doesn't cut it in a corporate election today.

*What about block chain technology? Would that help?*

Schorr: Institutional holders and Main Street investors need to have some ability to know that their shares have actually been voted and that their votes have been included in the final vote count. Blockchain, which has a distributed ledger, is one approach that could possibly do that. It may be one way of ensuring that the chain of custody and the voting of shares takes place. Delaware Vice Chancellor Travis Laster gave a speech at the Council of Institutional Investors in September 2016, proposing Blockchain as a way of providing better accuracy, transparency and efficiency for settling securities trades and voting in corporate elections. Another way? You could have a simple book-entry system of the sort suggested by New York University Law Professor Ed Rock.

Schorr: Based on our experience, we think it is appropriate to step back and review where our proxy system voting system is today and seek answers to the various questions and issues we have talked about. While there may not necessarily be a silver bullet solution to all of the issues we have highlighted, we believe the subject of proxy plumbing reform merits a close review.