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## Market Trends: Shareholder Proposals

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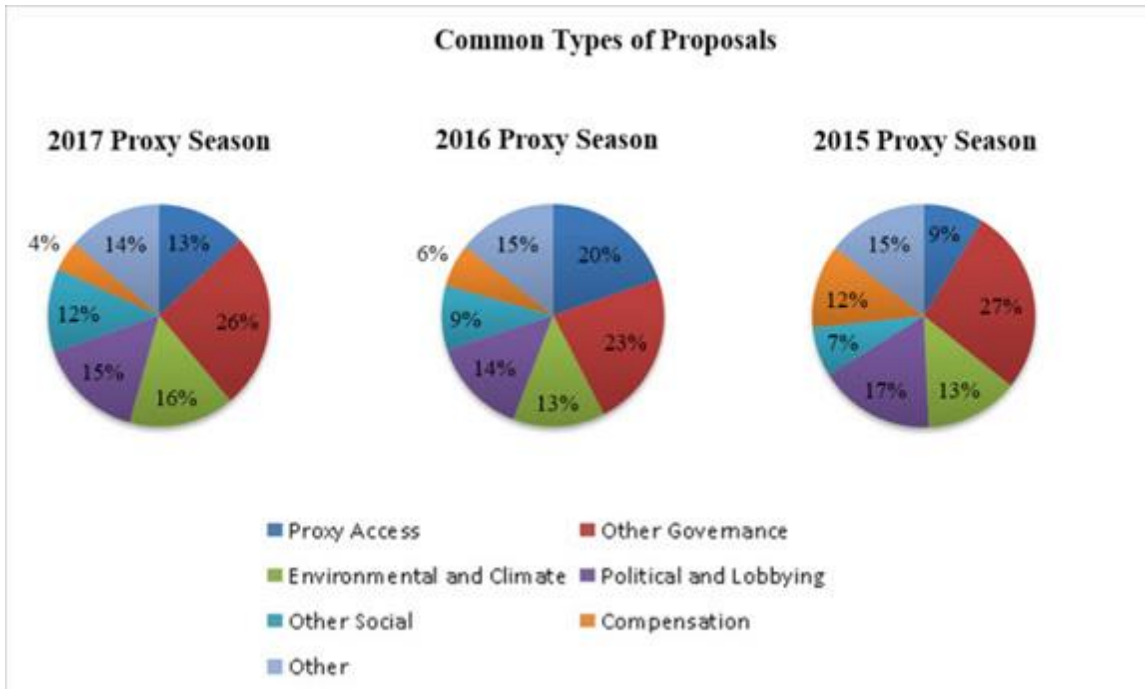
### Overview

Shareholder proposals are a popular and effective mechanism enabling shareholders to recommend or require that a company and/or its board of directors take a specified action. To be eligible to submit a proposal for consideration at a meeting of the company's shareholders and have such proposal included in the company's proxy statement and proxy card under federal law, a shareholder must have held company shares with a market value of at least \$2,000 (or at least 1% of the company's securities entitled to vote on the proposal at the shareholder meeting) for at least one year, and comply with additional substantive and procedural rules set forth in Rule 14a-8 (17 C.F.R. § 240.14a-8) under the Securities Exchange Act of 1934, as amended (the Exchange Act). There has been criticism that the dollar threshold in Rule 14a-8, which was adopted decades ago in 1998, is too low. See e.g., Comment Letter of The Business Roundtable, File No. S7-25-97 (Dec. 9, 1997). It is possible that this threshold may be raised in the future and that other reforms may be made to the shareholder proposal process. Alternatively, albeit infrequently used, a shareholder may submit a proposal under state law, without regard to the requirements of Rule 14a-8, but must bear the cost of preparing and mailing its own proxy statement to the company's shareholders. For additional information on shareholder proposals, see [Excluding Shareholder Proposals and Seeking No-Action Letters](#) and [Rule 14a-8 Shareholder Proposals Timetable](#). For additional information on the proxy and annual meeting process in general, see [Proxy Statement and Annual Meeting Resource Kit](#).

After a significant increase in the frequency of shareholder proposals in the 2015 proxy season—due in large part to the prevalence of proxy access proposals described below—the number of shareholder proposals submitted to U.S. public companies has been decreasing somewhat (from 943 in 2015, to 916 in 2016, down to 861 in 2017), though the number of proposals still exceeds the 2013 level (820), according to the Institutional Shareholder Services (ISS) Voting Analytics database and other privately sourced data. (All 2017 data herein is as of July 1, 2017.) As the number of shareholder proposals submitted has increased since 2013, however, the average investor support for shareholder proposals has actually been declining over the past five years, down from 34.4% in 2013 to 29.8% in 2016 and 25% in 2017.

As discussed in detail below, prior trends are expected to continue. In particular, it is expected that:

- The pressure to adopt proxy access bylaws will continue to increase at large-cap companies and begin spreading to mid-cap companies.
- Proponents of proxy access will attempt to refine proxy access bylaws by proposing amendments to existing proxy access bylaws.
- Other governance-related proposals will decline at large-cap companies, but increase at mid-cap companies.
- Specific compensation-related proposals will reappear in light of high-profile controversies and legislative uncertainty.
- Shareholder support for environmental and social topics and board diversity—gender diversity in particular—will increase.
- While less common, shareholder proposals may continue to address economic/business issues and be put forward by economic-oriented activists/hedge funds (e.g., Greenlight's spring 2017 proposal at General Motors, which ultimately failed).



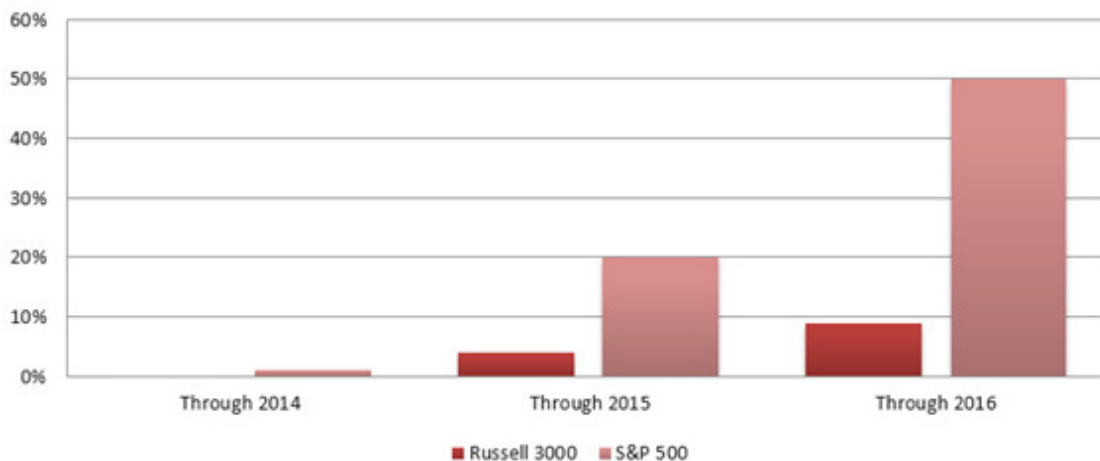
**Governance**

**Proxy Access**

Proxy access gives shareholders who meet specified conditions the right to include one or more shareholder-nominated candidates for election to the board of directors in the company’s proxy statement and on its proxy card. Since 2015, proxy access has been one of the more dominant shareholder proposals at large-cap companies and the most likely type of shareholder proposal to obtain majority shareholder support. This has resulted in a majority of S&P 500 companies adopting some form of proxy access, either as a result of a successful shareholder proposal or due to voluntary adoption of a proxy access bylaw with terms consistent with market practice.

Given this widespread adoption, pressure to adopt proxy access at remaining large-cap companies is likely to increase, but the focus of proponents of shareholder proposals may begin shifting to the amendment or refinement of existing proxy access bylaws. However, unless they target real outliers, fix-it proposals that make it to a vote will likely fare poorly—during the 2016 and 2017 seasons, all proposals for bylaw amendments failed at every company that had already adopted proxy access with market standard terms (i.e., those that permit a shareholder, or group of up to 20 shareholders, owning 3% or more of the company’s common stock continuously for at least three years, to nominate up to 20% of the company’s board).

### U.S. Companies with Proxy Access Bylaws



While during the 2015 season and much of the 2016 season companies often excluded proxy access proposals on the basis of a conflicting management proposal on the same topic, recent guidance issued by the Securities and Exchange Commission (SEC) has narrowed the ability of companies to exclude shareholder proposals. See [SEC Staff Legal Bulletin No. 14H](#) (October 22, 2015) and [Legal and Regulatory Trends](#) below. As a result, proxy access proposals that were excluded in 2017 were primarily excluded on the basis of substantial implementation by the company, rather than a conflicting management proposal.

### ***Separate Chairman and CEO***

Shareholder proposals regarding the separation of the chairman and chief executive officer (CEO) positions are common, as they have been for a number of years. While still popular, the total number of these proposals decreased in 2016 and 2017 at S&P 500 companies (41 and 36, respectively) as compared to 2015 (55), due in large part to their low success rate in 2015 (average 3.6% of support and none achieved majority support in 2016). This decline in proposals has also been seen in the subset of independent chair proposals that were actually submitted for a shareholder vote, rather than withdrawn by the proposing shareholder or omitted by the company; however, the proposals that ultimately make it to a vote have seen modest increases in support.

<b>Independent Chair Proposals Submitted to a Vote (Excludes Withdrawn or Omitted Proposals)</b>								
# of Proposals Voted On			Average % Support			Proposals Passed		
2017	2016	2015	2017	2016	2015	2017	2016	2015
31	35	44	33.5%	27.0%	30.1%	0	0	2

Although proxy advisory firms such as ISS and Glass Lewis generally support these proposals, investors increasingly are of the view that a lead independent director with broad powers and responsibilities is an acceptable alternative to separation of the chairman and CEO roles. For additional information on proxy advisory firms and their role, see [Understanding the Role of Proxy Advisory Firms](#), [Preparing for ISS Proxy Voting Recommendations Checklist](#), and [Market Trends: Additional Proxy Soliciting Materials Responding to Negative Voting Recommendations](#).

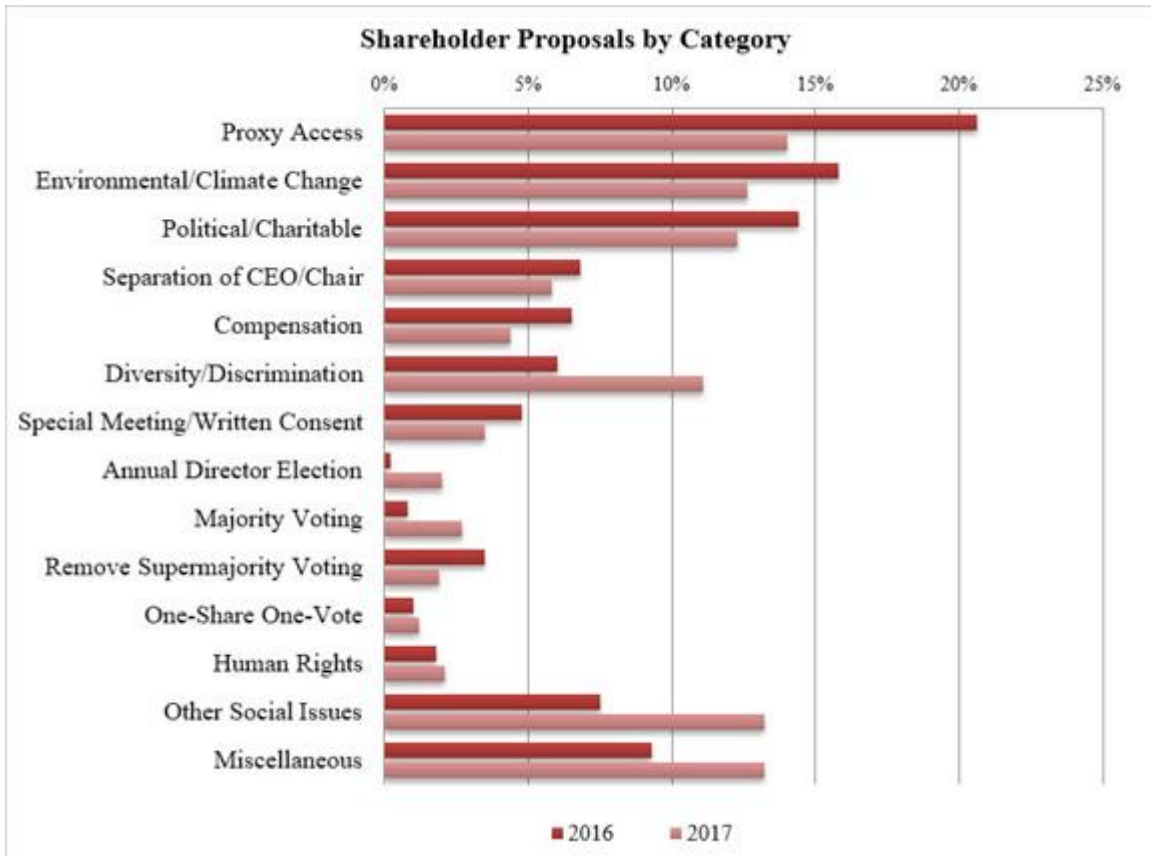
Due to the low overall success rate of these proposals over the past few years, whether due to a withdrawal, omission, or failed vote, shareholder proponents may be more selective going forward about the companies targeted with this type of proposal. Instead, shareholder proponents may focus on companies with more significant or pervasive performance or governance concerns in order to garner higher support. For additional information on the chairman, CEO, and lead director roles, see [CEOs, Chairs and Lead Directors: Who Leads the Board?](#). For model proxy disclosure relating to the issue of separation of the CEO and chairman positions, see [Model Proxy Disclosure: Combined CEO and Chairman](#) and [Model Proxy Disclosure: Split CEO and Chairman](#).

### ***Shareholder Off-Cycle Action Rights***

Proposals regarding shareholders' right to call a special meeting or to act by written consent are also relatively common.

A significant majority of large-cap companies already grant shareholders the right to call special meetings, so most new shareholder proposals on the topic call for a reduction in the ownership threshold of existing special meeting rights.

Additionally, proposals requesting that companies permit shareholders to act by written consent have dropped significantly since 2015. The shift of focus to proxy access is partially responsible for this decrease, but many investors have also come to believe that special meeting rights are a sufficient (and more appropriate) mechanism to allow shareholder action outside of the annual shareholder meeting.



**Other Governance Topics**

Traditional governance proposals, such as board de-staggering, majority voting, and elimination of supermajority voting, have become less common as most large-cap companies have already adopted these measures. Rather than turning their attention to the same issues at smaller companies, proponents of shareholder proposals have typically moved on to new causes, the most notable being proxy access. Nevertheless, in 2016 the Council of Institutional Investors announced a campaign to target close to 200 Russell 3000 companies that still have a plurality standard in director elections, and such proposals typically pass when submitted. See Council of Institutional Investors, [Majority Voting for Directors](#).

**Compensation**

The 2016 proxy season marked a five-year low for the number of compensation-related shareholder proposals voted upon—and none received majority support. This is due in large part to the required say-on-pay votes, which provide investors an alternative mechanism to express their approval or disapproval of a company’s executive compensation program. For additional information on say-on-pay, see [Complying with Dodd-Frank’s Say-on-Pay Provisions](#).

However, a number of proposals on new compensation topics surfaced in 2016, including calls to adjust incentive metrics to account for share buybacks and the prohibition of government service golden parachutes. Although none received majority support, one proposal at Xerox to adjust incentive metrics to account for share buybacks did receive 45.6% support. See Sydney Carlock, et al., 2016: Proxy Season Review – Compensation, ISS Report Center (Sept. 22, 2016). For information on golden parachutes, see [Guide to Disclosure and Shareholder Vote for Golden Parachute Compensation](#).

While compensation-related proposals had been on the decline, in light of recent high-profile controversies and uncertainties surrounding legislative solutions, the 2017 season actually saw an increase in the number of proposals on compensation, in particular compensation clawbacks. Additionally, due to investors’ heightened focus on climate change, shareholder proponents submitted eight proposals relating to the linking of executive pay to sustainability or climate metrics. More of these may be on the horizon. For further information on sustainability, see [Introduction to Corporate Sustainability](#).

## Environmental and Social

Proposals relating to environmental and social issues were the most common proposal type at S&P 500 companies for each of the last five years (up to 354 in 2017). This figure includes all topics in the broad environmental and social category, including climate change and climate regulation; environmental health and safety; political, lobbying, and charitable disclosure; human rights; diversity, gender, and discrimination topics; and other miscellaneous social topics. Specifically, proposals requesting increased climate risk disclosure had greater support in 2017 (33.7%) and 2016 (34.5%) as compared with 2015 (23.2%). Although the 2016 proxy season did not see majority support for environmental and social proposals, the increasing support culminated in the passage of climate-related proposals at four S&P 500 companies in 2017, most notably support by 62% of ExxonMobil shareholders for a proposal that requires ExxonMobil to report on the impacts of climate change to its business. In 2016, only 38% of ExxonMobil shareholders supported a substantially identical proposal, indicating the rapid pace at which shareholder support for climate related proposals is increasing year over year.

Support from large institutional investors for shareholder resolutions on climate change is also increasing. For example, State Street backed 51% of such resolutions in 2016, compared with only 14% in 2015. See Shirley Westcott, [Proxy Advisors and Investors Prep for 2017 Proxy Season](#), Harvard Law School Forum on Corporate Governance and Financial Regulation (Dec. 22, 2016). Additionally, a number of significant institutional investors have recently committed to supporting enhanced climate risk disclosure. BlackRock, which holds a stake in most major U.S. public corporations, identified climate risk as one of its top engagement priorities for 2017. See [Annual Letter to CEOs from Larry Fink](#), Chairman and Chief Executive Officer of BlackRock (Jan. 24, 2017).

In addition to climate and sustainability proposals, shareholder proposals relating to political expenditures and lobbying are common, though decreasing. Notably, conservative shareholder groups have joined their progressive counterparts in putting forth shareholder proposals on social issues. However, shareholder support for proposals on these topics is generally quite low, with only two proposals out of 61 voted on in 2016 receiving majority support. See Glass Lewis, [2016 Season Review: United States and Canada Governance Lessons from January to June 2016](#) (Aug. 31, 2016). In 2017, none of the 50 political/lobbying proposals that went to a vote received majority support.

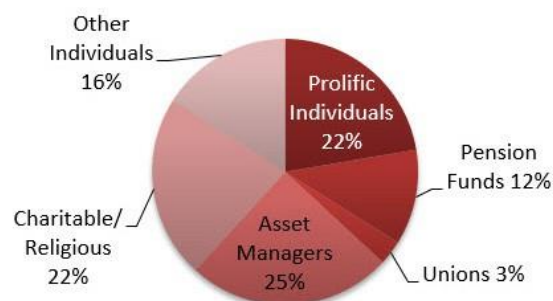
Finally, gender pay equity garnered increasing attention in the 2016 and 2017 proxy seasons, highlighted by the increased shareholder support for a proposal at eBay to sponsor a gender equality study that was submitted in each of the 2015 and 2016 proxy seasons. The proposal received only 8.5% support in 2015, followed by 51.2% support in 2016 to pass.

## Proponents

The most prolific proponents of shareholder proposals are individual investors John Chevedden, James McRitchie, William and Kenneth Steiner, and Jing Zhao. Chevedden alone accounts for approximately 14% of all shareholder proposals submitted in the 2017 season. Individuals of this ilk are sometimes referred to as “gadfly investors” as their interests are generally not as typical investors but to instigate and bring about change. The New York City Comptroller submitted a large number of shareholder proposals on behalf of five New York City pension funds in 2015 and 2016, primarily focused on proxy access as part of the Comptroller’s “Boardroom Accountability Project.” The initiative targets companies where three priority issues generate concerns: (1) climate change risk, (2) board diversity, and (3) excessive executive compensation. In 2017, the Comptroller was less active in submitting proposals related to proxy access. Instead, the Comptroller focused its attention in 2017 on proposals requesting enhanced sustainability disclosure.

Other proponents of shareholder proposals include:

- Public pension funds, which focus their proposals mainly on governance issues related to board diversity and social proposals relating to employee diversity, political contribution disclosure, and environmental issues
- Labor unions, which focus primarily on governance and compensation-related issues
- Asset management or advisory institutions, which focus on environmental and social issues



## Legal and Regulatory Trends

The 2017 proxy season has unfolded during a time of considerable legal and regulatory uncertainty across a broad range of topics. In particular, the regulation of proxy advisors may gain traction with the new U.S. administration, giving proxy advisors reason to actively engage with companies as they shape their voting recommendations. Both ISS and Glass Lewis have new staff members in critical roles, and therefore institutional knowledge and precedent may not carry the same weight as in prior years.

In addition, the regulatory framework addressing no-action relief for the exclusion of shareholder proposals from proxy materials is evolving. Generally, a company may exclude a shareholder proposal from its proxy materials if the proposal fails to meet any of the procedural and substantive requirements of Rule 14a-8. A company may seek no-action relief from the SEC to exclude a proposal from its proxy materials on a number of additional grounds, most usually because of a direct conflict with a management proposal (Rule 14a-8(i)(9)) or because there has already been substantial implementation of the proposal (Rule 14a-8(i)(10)).

In the fall of 2015, the SEC issued Staff Legal Bulletin No. 14H, making it more difficult to obtain no-action relief on the direct conflict ground. After initially granting no-action relief to Whole Foods for a shareholder proposal seeking to amend the company's existing proxy access bylaw, the SEC reversed course and refused to grant no-action relief on the basis of a direct conflict. The SEC stated that it would permit a company to exclude a shareholder proposal on the basis that it directly conflicts with a management proposal only "if a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one proposal is tantamount to a vote against the other proposal."

As a result, proposals with similar objectives on different terms will not be considered to directly conflict with one another. In light of this development, the number of ballots containing competing proposals increased in the 2016 and 2017 seasons. The board of directors in such a circumstance may have to consider the effects of both proposals, and any company that includes a shareholder proposal and a management proposal on the same topic may have to include proxy statement disclosure explaining the differences between the proposals and how the company expects to consider the voting results.

Following the issuance of Staff Legal Bulletin No. 14H, a higher proportion of no-action requests were made on the basis of substantial implementation. The substantial implementation ground permits exclusion if a company has satisfied the essential objective of the proposal. While this basis for exclusion remains viable in many cases, in July 2016 the SEC denied no-action relief on the basis of substantial implementation in the case of a proxy access bylaw when the provision already implemented by the company was very similar to that proposed. The denial suggests that companies may not easily be able to rely on substantial implementation as a basis to exclude shareholder proposals calling for revisions to proxy access bylaws, though it is likely still a basis for exclusion of proxy access adoption proposals. In certain cases, proposals to revise existing proxy access bylaws will still be excludable. For further information, see [Rule 14a-8 Stockholder Proposal Exclusion Flowchart](#).

## Market Outlook

Overall, the rate of shareholder proposals across all topics should remain relatively stable, with individual investors such as John Chevedden continuing to submit a large quantity of proposals at an array of companies.

Fix-it campaigns to amend existing proxy access bylaws are expected to continue and, as more companies adopt proxy access, increase in frequency. Proposals targeted at companies with primary proxy access provisions that already conform to the market standard are not likely to generate significant shareholder support, but proposals at companies that significantly deviate will likely attract more support.

As noted above, while traditional governance-related proposals have focused on large-cap companies, now that the majority of such companies have adopted the proposed measures, investors may begin to shift focus to small- and mid-cap companies.

Companies should also expect a high number of proposed resolutions on climate change, requests for lobbying and political expenditure disclosure, and workplace diversity. Climate-related proposals will likely see increasing support, and companies should be attentive to changes in their investors' voting policies and practices to best prepare and predict the outcome of proposals that go to a vote.

As in past years, boards that are seen as insufficiently responsive to shareholder votes may suffer from a negative ISS or Glass Lewis recommendation. With the uncertainty surrounding the legal and regulatory framework for the exclusion of shareholder proposals, companies should be prepared to include shareholder proposals and provide thoughtful and well-reasoned recommendations for or against such proposals.

### ***Approaches to Proxy Season***

Given the change in leadership at both ISS and Glass Lewis, companies should refresh and update their proxy advisor outreach plans to ensure a clear narrative, in addition to their plans for shareholder engagement. For additional information, see [Board Engagement with Shareholders Policy Checklist](#). Companies should develop a keen understanding of shareholder perspectives on the company and foster long-term relationships with major shareholders, including by appropriately handling shareholder requests to discuss governance, the business portfolio, capital allocation and operating strategy, environmental, and social and governance matters, and for greater transparency into the board's practices and priorities. Companies should also integrate business relevant environmental and social governance considerations into long-term strategy and be prepared to respond to increasing investor attention on the topic.

Boards should evaluate every shareholder proposal thoughtfully and resist changes that the board believes will not be constructive, while addressing any modifications that in the board's judgment will result in transparent, good governance and promote the long-term interests of shareholders.

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