Market Trends 2019/20: Shareholder Proposals

A Lexis Practice Advisor® Practice Note by Trevor S. Norwitz, Sabastian V. Niles, Carmen X. W. Lu, and Justin C. Nowell, Wachtell, Lipton, Rosen & Katz

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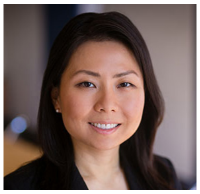

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This practice note discusses recent market trends related to shareholder proposals, a popular and effective mechanism enabling shareholders to recommend or require that a company and/or its board of directors take a specified action. To be eligible to submit a proposal for consideration at a meeting of the company's shareholders and to 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 14a8 (17 C.F.R. § 240.14a-8) under the Securities Exchange Act of 1934, as amended (the Exchange Act).

For additional information on shareholder proposals, see Proxy Statement and Annual Report Drafting, Solicitation, and Distribution 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. For other market trends articles covering various capital markets and corporate governance topics, see Market Trends.

In November 2019, the Securities and Exchange Commission (SEC) released proposed amendments to Rule 14a8, which among other things, proposes to increase the dollar threshold to $20,000 for shareholders who have held the shares for only one year and to $15,000 for shareholders who have held shares for only two years. The proposed amendments reflect ongoing criticism that the dollar threshold in Rule 14a8, which was adopted decades ago in 1998, is too low. See, e.g., Comment Letter of The Business Roundtable, File No. S7-23-19 (Feb. 3, 2020). In addition, the proposed amendments limit the ability of shareholders to submit multiple proposals at a single meeting and impose additional restrictions on the resubmission of proposals.

Under Rule 14a8, a company may seek to exclude certain shareholder proposals for a variety of reasons, such as relevance, violation of laws or proxy rules, interference with management functions or conflicts with the company's proposals. In September 2019, the Division of Corporation Finance of the SEC announced that beginning with the 2019-2020 proxy season, SEC staff may determine to respond orally, instead of in writing, to some no-action requests from companies seeking to exclude Rule 14a8 shareholder proposals. The SEC added that should it decline to take a view on an exclusion request, such silence should not be interpreted "as indicating that the proposal must be included." It remains to be seen how the SEC's revised approach will impact companies' engagement with proponents, and whether companies will increasingly negotiate with proponents for a withdrawal of a shareholder proposal as opposed to historically seeking written no-action relief from the SEC.

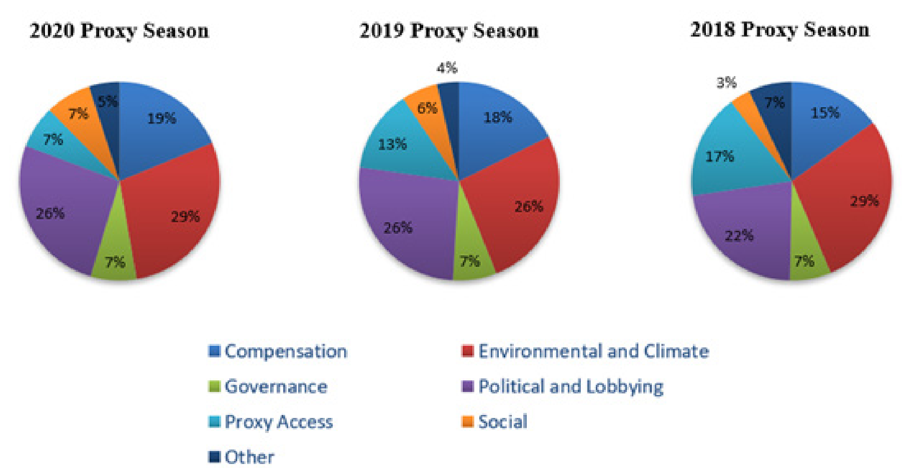
Alternatively, albeit infrequently used, a shareholder may also submit a proposal under state law, without regard to the requirements of Rule 14a8, but must bear the cost of preparing and mailing its own proxy statement to the company's shareholders.

The total number of shareholder proposals submitted to U.S. public companies has continued to trend downwards in recent years (from 819 in 2017, to 809 in 2018, to 807 in 2019, and down to 775 in 2020), according to the Institutional Shareholder Services (ISS) Voting Analytics database and other privately sourced data. (All 2020 data herein is as of June 9, 2020.) The average investor support for shareholder proposals has fluctuated in recent years, from 24.8% in 2018 to 25.2% in 2019 and down to 23.53% in 2020. Nonetheless, 2020 is shaping up to be a notable year for climate-related shareholder proposals, with a record number of proposals receiving majority shareholder support.

Looking ahead, shareholder proposals will likely mirror growing shareholder scrutiny toward sustainability practices and climate-related risk disclosures, as well as human capital management and other environmental, social, and governance (ESG)-related matters. In particular, it is expected that:

- Environmental and social proposals will continue to see growth as shareholders increasingly focus on issues such as executive compensation, human capital management, and oversight and planning in connection with climate-related risks
- Social concerns arising out of the COVID-19 pandemic, notably worker health and safety and social impact and purpose, may become popular in the upcoming proxy season
- Shareholder proposals will continue to focus on traditional corporate governance matters, with the most common proposals relating to the appointment of an independent board chair, disclosure on political contributions, board diversity, and director overboarding
- Specific compensation-related proposals will reappear in light the COVID-19 pandemic and renewed focus on pay disparities within a company's workforce
- Shareholder support for workforce and board diversity—gender diversity on boards in particular—will continue to increase
- While less common, shareholder proposals may continue to address economic/business issues and be put forward by economic-oriented activists/hedge funds

Common Types of Proposals



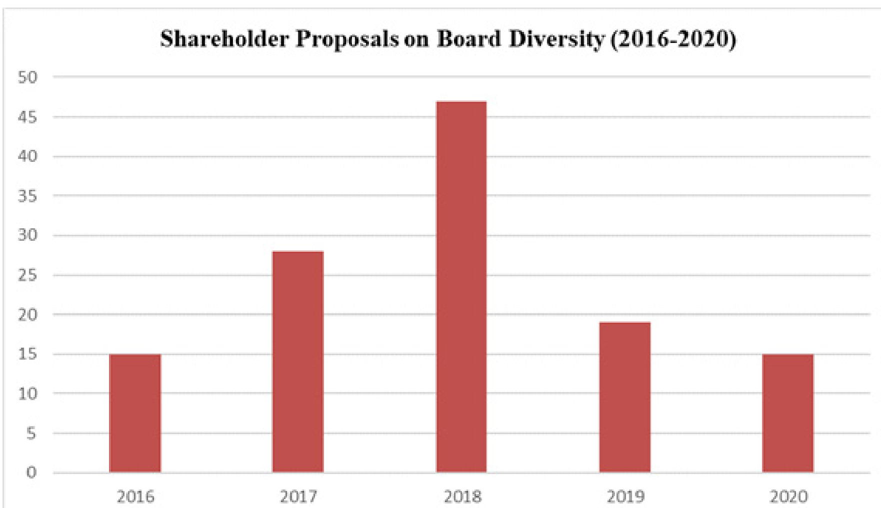
Governance

Board Diversity

Board diversity, notably gender and ethnic diversity, remain a key concern of shareholders with focus expanding beyond board diversity to include management diversity and diversity in the workforce. It is likely that these trends will continue to accelerate in the coming years as shareholders and regulators continue to scrutinize diversity at all levels. A number of the largest institutional shareholders, including BlackRock, State Street, and Vanguard, have publicly called on companies to improve gender diversity on boards. Out of the nearly 50 shareholder proposals regarding diversity that were submitted in 2019, four proposals received majority support. A similar number of shareholder proposals were filed in the 2020 proxy season with new proposals asking companies for analysis of corporate diversity programs and data on diversity in different job categories and related affirmative action.

Shareholder voting policies continue to support increased board diversity and inclusion: BlackRock's voting policies state that BlackRock will vote against nominating and governance committee members of companies that fail to improve diversity where there are fewer than two women directors on the board. Vanguard will also vote for shareholder proposals that seek disclosure of diversity polices and skills matrices (which have become an increasingly common feature of proxy statements). Proxy advisor ISS will also generally recommend voting against the chair of the nominating committee and other directors, on a case-by-case basis, if there are no women serving on the board as of the previous annual meeting.

Regulators have also weighed into board diversity, with a number of states, including New Jersey, Michigan, and Pennsylvania, following California's lead to mandate women directors for companies headquartered in those states. Other states, such as Illinois, Maryland, and New York, have introduced laws that require disclosure of board and/or management diversity.



Separate Chairman and CEO

Shareholder proposals regarding the separation of the chairman and chief executive officer (CEO) positions saw an uptick in support in 2020 as changes in the voting policies of institutional investors such as State Street led to growing scrutiny of the robustness of the roles of lead independent directors. This year saw 45 shareholder proposals calling for an independent chairman, down from the 59 proposals filed in 2019. However, support for such proposals rose to 34.2% in 2020 compared to 30.2% in 2019 and 31.6% in 2018. While companies in the past have successfully argued that the separation of the chairman and CEO roles is a strategic decision that should be left to the discretion of boards, institutional investors have continued to express a growing preference for a robust lead independent director and have, in some cases, lent support to calls for a separation of chairman and CEO roles, particularly where there are other governance concerns or contingencies. For example, AT&T agreed to separate its chair and CEO roles as part of its settlement with activist investor Elliott Management Corporation in 2019. Similarly, Boeing stripped its CEO Dennis Muilenberg of his chairman title last year following the Boeing 737 Max groundings. 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.

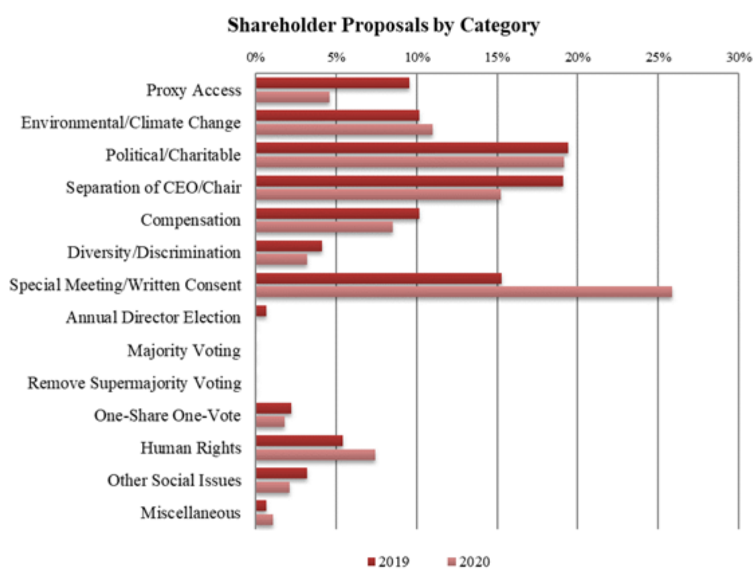
Proxy advisory firms have been traditionally vocal in recommending a separation of the chairman and CEO roles. For additional information on proxy advisory firms and their role, see Proxy Contest Preparation and ISS Proxy Voting Recommendations Preparation Checklist.

Independent Chair Proposals Submitted to a Vote (Excludes Withdrawn or Omitted Proposals)								
# of Proposals Voted On	Average % Support	Proposals Passed						
2020	2019	2018	2020	2019	2018	2020	2019	2018
38	48	37	34.20%	29.87%	32.16%	1	0	0

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 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. While institutional shareholders will generally vote in favor of amendments to the governance documents to enhance shareholder franchise via the right to call a special meeting or to act by written consent, many have also indicated a need to balance the need to expand shareholder franchise with the need to prevent a minority of shareholders from dominating key decision-making. As such, many key institutional investors will not vote in favor of recommendations to lower the ownership threshold required to access such rights.



Other Governance Topics

Traditional governance proposals focused on removing takeover defenses and increasing board accountability, such as board destaggering, majority voting, and elimination of supermajority voting, have become less common as most large-cap companies have already adopted these measures. However, such proposals continue to receive significant shareholder support: in 2020, eight proposals to reduce supermajority voting were passed, five amendments to destagger the board were passed, and three proposals eliminating majority voting were passed.

Compensation

Continuing on trends in recent years, shareholders continue to scrutinize say-on-pay proposals, 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 Dodd-Frank's Say-on-Pay Provisions Compliance.

In 2020, average support for say-on-pay proposals remained strong, with 90.7% of companies receiving majority support, a slight decrease compared to 2019 (90.8%) and 2018 (90.9%). For information on golden parachutes, see Disclosure and Shareholder Vote for Golden Parachute Compensation Guide.

In light of the COVID-19 pandemic, compensation issues may come to the fore, particularly as they relate to pay disparities within companies, compensation mix, and performance targets. Additionally, due to investors' heightened focus on climate change and other ESG issues, shareholder proponents submitted eight proposals relating to the linking of executive pay to sustainability or climate metrics. More of these proposals may be on the horizon. For further information on sustainability, see Corporate Sustainability.

Environmental and Social

Climate-focused proposals have attracted significant attention, with climate-related shareholder proposals accounting for approximately 21% of all proposals filed and five proposals receiving majority support as of June 11, 2020, a significant uptick from 2019, when no such proposals were passed. Many of the shareholder proposals focus on how companies plan to address climate-related risks and disclosures on how companies are planning to adapt to a low-carbon economy. Other climate-related shareholder proposals request reporting on energy efficiency and renewable energy as well as environmental management. Notwithstanding the impact of the COVID-19 pandemic, it is likely that climate and sustainability-related proposals will continue to grow as key institutional shareholders, notably BlackRock and State Street, continue to call for greater disclosure of climate-related risks and business strategies to adapt to a low-carbon economy.

Other 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, diversity-focused proposals continue to gain traction, with focus shifting beyond the boardroom into management and the workforce, reflecting growing concern regarding human capital management. The New York City Comptroller's Office has been particularly active in pushing for greater diversity: in 2020, the Comptroller's Officer submitted shareholder proposals at 17 companies that it viewed did not implement its request to include consideration of qualified women and ethnically diverse candidates. Thirteen of those proposals were withdrawn after the target companies adopted policies requiring consideration of diversity in director and CEO searches; among the four remaining companies, one proposal received majority support.

In addition to climate and sustainability and diversity-related proposals, shareholder proposals relating to political expenditures and lobbying continue to be common, with three proposals receiving majority support in 2020. 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 three proposals out of 53 voted on in 2020 receiving majority support.

Looking ahead, it is likely that environmental and social issues will continue to increase as the COVID-19 pandemic has exacerbated a number of social issues, including issues related to lobbying and political contribution disclosures, board composition, and human capital management.

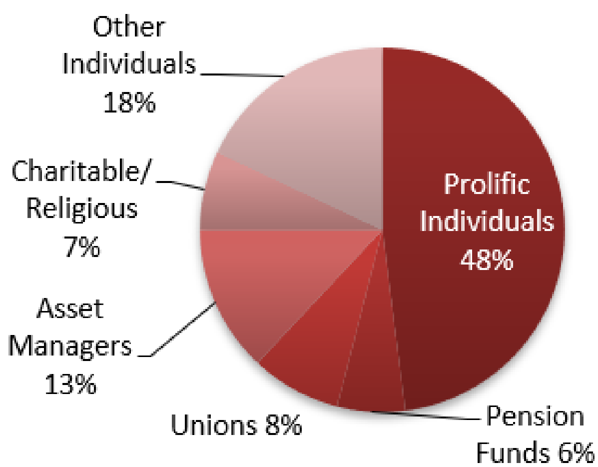
Proponents

The most prolific proponents of shareholder proposals are individual investors: John Chevedden, James McRitchie, Myra Young, and William and Kenneth Steiner. Chevedden alone accounts for approximately 18% of all shareholder proposals submitted in the 2020 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. As part of its Boardroom Accountability Project, the New York City Comptroller has also become an active filer of shareholder proposals relating to diversity and the adoption of the "Rooney Rule," a policy originally created by the National Football League to increase the number of minority candidates considered for head coaching and general manager positions, for director and CEO searches.

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 primarily focus on governance and compensation-related issues –and–
- Asset management or advisory institutions, which primarily focus on environmental and social issues

Shareholder Proposals by Proponent



Legal and Regulatory Trends

The 2020 proxy season was overshadowed by the COVID-19 pandemic, whose impact will likely continue to be felt going forward. For an overview of practical guidance on COVID-19 covering various practice areas, including capital markets, see Coronavirus (COVID-19) Resource Kit. Among the key trends is a growing focus among shareholders on ESG issues, particularly with respect to climate change and human capital management. While such concerns are yet to be reflected in regulatory shifts, the SEC has indicated that it has established subcommittees to provide recommendations on ESG and related disclosures. The Investor Advisory Committee has already recommended that the SEC "begin in earnest an effort to update the reporting requirements of Issuers to include material, decision-useful, ESG factors." While the SEC has not indicated that it plans to move beyond its current materiality standards with respect to mandated public disclosures, the demand from shareholders for ESG data is likely to continue and may result in a further uptick in environmental and social shareholder proposals. It is also notable that proxy advisory firm ISS recently launched its Climate Voting Policy, which, together with its Sustainability Voting Policy, will likely lend support for ESG-related shareholder proposals.

Amid the COVID-19 pandemic, businesses that availed themselves of federal aid may also see scrutiny over compliance of their terms. In particular, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) imposes, among other things, limitations on executive compensation, mass layoffs of employees, dividends, and share buybacks. Even companies that did not seek CARES Act relief may face increased shareholder scrutiny with respect to compensation and workforce-related matters. Shareholder proposals seeking disclosure on pay disparities and workforce retention may become more common in the coming proxy season.

It is also notable that the SEC has continued to revise the proxy rules, with the latest proposed changes setting heightened restrictions on shareholders seeking to include their proposals on the company's proxy statement. The proposal increases the dollar threshold and the holding period required to submit a proposal could make it more difficult for smaller shareholders, and potentially gadfly investors, to submit proposals. In addition, the SEC's announcement that should it decline to take a view on an exclusion request, such silence should not be interpreted "as indicating that the proposal must be included," may encourage more companies to exclude shareholder proposals.

A company looking to submit a no-action letters with respect to a shareholder proposal should also pay attention to the October 2019 guidance issued by the Division of Corporation Finance in which the SEC noted that its decision whether or not to exclude a shareholder proposal under the "ordinary business" exception of Rule 14a8(i)(7) is guided by consideration of the significance of the subject matter and whether the proposal seeks to micromanage the company. In drafting a no-action letter, a company may wish to eschew a one-size-fits-all or an overly technical approach in justifying why no-action relief is justified, and tailor its disclosures on company-specific facts and circumstances. For further information, see Rule 14a-8 Stockholder Proposal Exclusion Flowchart.

Market Outlook

Overall, while the aggregate number of shareholder proposals will likely remain stable going forward, environmental and social proposals may increasingly feature alongside more traditional governance proposals. In particular, companies should expect a higher number of proposed resolutions on climate change, requests for lobbying and political expenditure disclosure, and human capital management. Climate-related and diversity 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. It is also important to note that while the legal duties of care owed by boards have not changed, large institutional investors, despite the uncertainty surrounding the long-term impacts of COVID-19, continue to uphold high expectations with respect to corporate governance and stewardship.

Approaches to Proxy Season

Heading into the next proxy season, companies should refresh and update their stakeholder and shareholder outreach plans to ensure a clear narrative that articulates the company's purpose and strategy for delivering sustainable long-term value to stakeholders. For additional information, see Board Engagement with Shareholders Policy Checklist. Companies should develop a keen understanding of stakeholder and 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, including feedback from stakeholder and shareholder engagement, into long-term strategies 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 decisions in the best interests of their stakeholders.

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Trevor Norwitz is a partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz where he focuses primarily on mergers and acquisitions and corporate governance matters. He has advised public and private entities across many industries in connection with mergers, acquisitions, divestitures, hostile takeover bids and defenses, proxy contests, joint ventures, financing transactions and corporate governance and crisis management situations.

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Sabastian advises worldwide and across industries, including technology, financial institutions, media, energy and natural resources, healthcare and pharmaceuticals, construction and manufacturing, real estate/REITs and consumer goods and retail.

He has counseled boards of directors and management teams on self-assessments, engagement with institutional investors and proxy advisory firms and navigating activist situations involving Barry Rosenstein/JANA Partners, Bill Ackman/Pershing Square, Carl Icahn, Daniel Loeb/Third Point, David Einhorn/Greenlight Capital, Glenn Welling/Engaged Capital, Jeff Smith/Starboard Value, Jeffrey Ubben/ValueAct, Jonathan Litt/Land & Buildings, Keith Meister/Corvex, Mick McGuire/Marcato, Nelson Peltz/Trian, Scott Ferguson/Sachem Head, Paul Singer/Elliott Management, Relational Investors and Tom Sandell/Sandell Asset Management, among many others.

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Justin serves on the Board of the Beginning with Children Foundation. Justin was selected as a 2020 Council of Urban Professionals (CUP) Fellow.