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2013 Proxy Season Preview: Key Shareholder Proposals

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Overview

The 2013 annual meeting season may lack the drama of last year's Occupy protests and impending presidential election but it will still have its share of challenges for issuers. Revisions to proxy advisors' pay models and peer groups are already spawning another round of supplemental proxies on Say-on-Pay (SOP), while threats of compensation disclosure strike suits have become this year's unwelcome sideshow.

This spring also promises another big wave of shareholder resolutions, with over 600 filed to date, though for the most part they will repeat the prevailing themes seen in past years. Public pension funds and other institutional proponents are methodically cleaning up S&P 500 and Russell 2000 firms that still have classified boards and plurality voting in director elections. Meanwhile, retail activists are boosting their share of proposals calling for independent board chairmen and compensation reforms, in addition to their perennial filings on supermajority voting, special meetings, and written consent.

Based on submissions to date, several unexpected trends stand out. The first is a renewed blitz of resolutions on corporate campaign finance, particularly indirect lobbying activities, following the record spending in the 2012 election cycle. Although not likely to gain ground in support levels, proponents are clearly keeping up the momentum on this issue in the hopes of eventual SEC rulemaking mandating disclosure of political spending. Filings of compensation-related proposals have also escalated this year, though many of these were part of a now-abandoned campaign by the United Brotherhood of Carpenters (UBC) to promote triennial SOP votes.

Noticeably scant are shareholder proposals to adopt proxy access compared to last year, and a number of those that have emerged are mirroring the SEC's proposed 3%/3-year regime that was successful at two companies in 2012. This year's milestone will be the first management proposals to implement proxy access bylaws—also following the 3%/3-year formulation—in response to past or renewed activist campaigns.

Votes on shareholder proposals will carry weightier implications for issuers going forward due to changes this year to proxy advisor policies. Boards that fail to adequately address shareholder ballot measures that receive significant support may face a greater likelihood of "withhold" recommendations from Institutional Shareholder Services (ISS) and Glass Lewis. ISS's withhold policy will take effect in 2014 for board inaction on shareholder resolutions that are approved by a majority of votes cast at a single annual meeting (i.e., 2013) rather than at multiple annual meetings. Glass Lewis will scrutinize board responses, and possibly oppose board members, beginning this year for shareholder proposals that received 25% or more support in 2012. Both proxy advisors expect issuers to disclose in their public filings how they have responded to the votes, including any outreach with top holders (see Alliance Advisors' January newsletter).

In light of these developments, this year will likely see a heightened degree of corporate-shareholder engagement as well as issuers being more proactive towards shareholder resolutions that most often receive majority support. Already over 50 companies have responded to shareholder proposal filings on board declassification, supermajority voting, special meetings, and written consent with corresponding management actions.

Below is a preview of key shareholder initiatives for the upcoming proxy season.

Proxy Access

This year's proxy access proposals are expected to be fewer in number but more refined in structure. Last year, out of 24 shareholder resolutions filed, only 12 made it to ballots, largely due to omissions, and the two that were ultimately successful (at Chesapeake Energy and Nabors Industries) followed the 3%/3-year ownership requirement of the SEC's defunct proxy access rule.

So far, a number of proponents are strengthening the eligibility requirements in their proxy access proposals to make them more palatable to investors: 3% for three years at Walt Disney (Hermes Equity Ownership Services) and Microwave Filter (Furlong Fund LLC), and 3% for one year at PMC Commercial Trust (Adam Goldstein).[1] Norges Bank Investment Management (NBIM), which sponsored six access resolutions in 2012, appears to be switching from binding to non-binding resolutions this year, though retaining its 1%/1-year formulation.

Although the U.S. Proxy Exchange (USPX) has suspended its centralized operations, its retail members are continuing to file proxy access resolutions, though not as many as in 2012. They have likewise revised their 2013 proposals in the hopes of winning support from ISS (which opposed all of USPX's 2012 resolutions) and investors at large. The new version, which has been submitted at iRobot, still retains an ownership option for retail investors, but sets a minimum holding period and a floor on ownership.[2] Proxy access would be allowed for:

- A party of one or more shareholders collectively holding between 1% and 5% of the shares for two years (Option A), or
- 50 parties each holding for one year shares valued at $2,000 in the past 60 days and collectively holding between 0.5% and 5% of the stock (Option B).

The number of shareholder nominees is capped at 48%: 24% for the Option A holders and 24% for the Option B holders.

Irrespective of how the resolutions are constructed, a key issue will be whether or not investors can be persuaded that proxy access is warranted at the companies targeted. Walt Disney, for example, was singled out for having recombined the chairman/CEO positions and for receiving low SOP support last year, but the company argues that the proxy access proposal is "a solution in search of a problem." So far, ISS, Glass Lewis, and the California State Teachers' Retirement System (CalSTRS) are siding with the proponent and endorsing both proxy access and a split of the chairman/CEO posts at Disney's March 6 annual meeting.

This will mark the first year that issuers are presenting their own resolutions to adopt proxy access. Hewlett-Packard, Chesapeake Energy, and Western Union are all sponsoring 3%/3-year bylaw proposals either in response to last year's shareholder campaigns or, in the case of Western Union, to counter a resubmission from NBIM, which last year was supported by 33.5% of the votes cast. Absent, however, is any proposed action by Nabors Industries on proxy access, which instead is trying to fend off a repeat proposal from the New York City pension funds. The company is arguing to the SEC that the proponent's references to a $100 million severance payment to the former CEO, which was never made, are materially false and misleading.

Board Declassification

The Harvard Law School Shareholder Rights Project (SRP) will again be the most active player in promoting annual director elections, having accounted for over 70% of the declassification proposals submitted last year. So far, the SRP's growing ranks of investor participants have filed almost 80 proposals at S&P 500

[1] As part of a proxy fight last year with Microwave Filter, which was ultimately withdrawn, the Furlong Fund included a proxy access proposal in its proxy materials. The proposal would have allowed a holder of 15% of the shares for one month to nominate up to one third of the board.

[2] USPX member Brett Davidson also submitted, but subsequently withdrew, a proxy access proposal at CSP, which followed last year's proposal format. CSP is facing a proxy fight this year from North & Webster LLC.

and Fortune 500 firms.[3] Of these, nearly half are resubmissions at companies where the shareholder proposals received majority support in 2012 and four are at companies where management resolutions to declassify failed last year.

Because of investors' overwhelming preference for annually elected boards, it is difficult for issuers to stand down shareholder proposals to repeal classified boards. Even in the face of compelling corporate rebuttals (Sally Beauty Holdings went so far as to issue a proxy supplement[4]), most declassification resolutions receive majority support, including all nine of those that have come to a vote so far in 2013. Therefore, issuers can expect campaigns like the SRP's to continue apace in years to come. According to a recent progress report, the SRP's efforts in 2011 and 2012 led to a one-third reduction in the number of S&P 500 companies with classified boards.[5] By the end of 2013, the SRP expects a majority of the remaining companies in the index that have staggered boards to move towards declassification.

Majority Voting

Union and public pension funds continue to spearhead efforts to advance majority voting in director elections through a combination of letter-writing, outreach, and shareholder proposal submissions. Last summer, CalSTRS announced that it would work its way down the Russell 2000 index where, according to FactSet Research, 73.5% of companies still have pure plurality voting. It is most often at these small and mid-cap companies where directors get rejected by shareholders. In 2012, 109 directors at 64 companies received a majority of opposition votes, and over 80% of these firms were outside of the Russell 1000 large-cap index. Because of plurality voting, these "zombie" directors typically remain on their boards.[6] This prompted the Council of Institutional Investors (CII) last fall to appeal to the American and Delaware bar associations to revise their corporate standards to require majority voting in director elections.

Some large investors, such as BlackRock, Fidelity and Vanguard, regard a director resignation policy as substantially equivalent to a majority vote standard. For this reason, majority voting proposals often fail at companies that already have a "plurality plus" standard (over 60% of the cases in 2012). While some proponents may withdraw a proposal if a company adopts a director resignation policy (as occurred at Ball and Health Care Realty Trust last year), others will continue to press for a full-fledged majority vote regime. In some cases, persistence pays off—as does patience. Following a two-year campaign by the California Public Employees' Retirement System (CalPERS), Apple agreed to amend its articles this year to adopt majority voting, and even enlisted CalPERS to lobby its 200 largest investors on its behalf. However, Apple and CalPERS will have a longer wait. At the urging of hedge fund Greenlight Capital, a federal judge blocked the vote on the charter amendment because it was bundled with the elimination of blank check preferred stock. Greenlight has been pressing Apple to unlock value by distributing high-yielding perpetual preferred shares.

Independent Chairman

Although they rarely receive majority support, shareholder proposals calling for an independent board chairman will be prevalent again in 2013. This year's resolutions, however, include a number of refinements. Some—but not all—proponents have removed references in their proposals to the stock exchanges' independence standards to avoid no-action challenges. While this language was commonplace in last year's

[3] Participants in the SRP include the Illinois State Board of Investments (ISBI), Massachusetts Pension Reserves Investment Management Board (PRIM), Los Angeles County Employees Retirement Association (LACERA), North Carolina Department of State Treasurer (NCDST), Ohio Employees Retirement System (OPERS), Florida State Board of Administration (SBA), School Employees Retirement System of Ohio (SERS), and the Nathan Cummings Foundation.

[4] Sally Beauty Holdings challenged the proponent's suggestion that shareholder value would be enhanced if the company followed the trend of other S&P 500 firms on declassification. Given that the company has significantly outperformed the index in recent years, the board argued that changing its longstanding governance simply to fall in line with other S&P 500 firms would be a "considerable disservice" to its shareholders.

[5] See http://blogs.law.harvard.edu/corpgov/2013/02/13/large-scale-governance-reforms-in-sp-500-companies/#more-40571.

[6] According to a study by GMI Ratings and the IRRC Institute, only 5% of directors at Russell 3000 firms who failed to receive majority support between 2009 and 2012 actually left their boards. See http://www.irrcinstitute.org/projects.php?project=59.

resolutions, six companies have successfully omitted them this year as vague and indefinite for referring to an external set of independence guidelines without defining them.[7] The 2013 resolutions also recommend phasing in an independent chairman upon the next CEO transition, which a number of companies are already contemplating.[8]

More irksome to shareholder activists are companies that reverse course and recombine the chairman and CEO positions. A proposal at Walt Disney by the Connecticut Retirement Plans and Trust Funds seeks an unusually strict policy that the CEO may only be chairman in extraordinary circumstances (as determined by the board) and for no more than six months. Last year, Disney appointed CEO Robert Iger as chairman until mid-2016, notwithstanding that the company's governance guidelines provide for an independent chairman unless the board determines otherwise. Other companies that will face activist backlash for reunifying their leadership posts include Sempra Energy, where an independent chairman proposal received majority support in 2012, and Ashford Hospitality Trust, where UNITE HERE is conducting a counter-solicitation to promote its bylaw amendment to separate the top jobs.

It remains to be seen whether there will be any significant shift in investor views on companies' leadership structures. Barring any serious problems at a firm, most shareholders are satisfied with a strong independent lead director.[9] A forthcoming study by Indiana University's Ryan Krause and Matthew Semadeni also refutes a "one-size-fits-all" approach to board leadership. The study found that there was no relationship between CEO duality and a company's performance among S&P 1500 and Fortune 1000 firms. According to the study, the roles of chairman and CEO should not be split simply as a matter of "best practice," but only when there is a performance problem, in which case the best corrective option is a "demotion strategy" whereby the CEO relinquishes the chairmanship and a new chairman is appointed.[10]

Board Diversity

Although not prominent among this year's shareholder resolutions, a long-term aspirational goal of shareholder activists is greater gender diversity on boards. According to 2012 studies by Catalyst and Governance Metrics International, women hold only 16.6% of board seats at Fortune 500 companies and 12.6% of board seats at S&P 1500 companies.[11]

State pension funds, social investment funds, and religious orders have banded together with women's groups in the 30% Coalition to promote gender diversity in boardrooms. While the coalition claims it is not advocating quotas, as is the practice in a number of European countries, its stated goal is for women to hold 30% of U.S. corporate board seats by 2015.[12] To accomplish this, the coalition has mapped out a strategy for the next several years of letter-writing, company engagement, and shareholder proposals. In recent months, the coalition has sent letters to 41 S&P 500 companies and 127 Russell 1000 companies and filed resolutions at 20 firms to improve their board diversity because they have no female directors. Nine of the proposals were withdrawn after the companies agreed to make diversity an intentional part of their board nominee search strategy.

While having a diverse mix of board members is a laudable goal, it is not an over-arching concern for most shareholders. In ISS's 2012 policy survey, investors and companies alike ranked gender/racial diversity as

[7] Most of the 2013 proposals either do not define "independent" or characterize it as a director who is not a current or former employee of the company and whose only non-trivial professional, familial or financial connection to the corporation or CEO is the directorship.

[8] A 2012 PricewaterhouseCooper's survey of 860 public company directors found that among boards with combined chairmen/CEOs, nearly half (47%) have discussed splitting the roles during the next CEO succession. See http://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/index.jhtml.

[9] For example, after an independent chairman proposal received majority support at Aetna in 2011, the company consulted its largest shareholders and decided to expand the duties of the lead director.

[10] See http://amj.aom.org/content/early/2012/07/20/amj.2011.0121.abstract.

[11] See http://www.catalyst.org/knowledge/2012-catalyst-census-fortune-500-women-board-directors and http://library.constantcontact.com/download/get/file/1102561686275-86/GMIRatings_WOB_032012.pdf.

[12] The European Union (EU) backed off from mandating gender diversity quotas at large listed companies but has set an "objective" for women to comprise at least 40% of non-executive directorships by 2020. Some European countries—Belgium, France, Iceland, Italy, the Netherlands, Norway, and Spain—already have mandatory quotas at the national level.

the *least* important of five factors in evaluating potential directors. Of greater importance is their experience in the industry sector, their skill sets relative to other directors, and their track record and attendance on other boards.

Supermajority Voting, Special Meetings and Written Consent

Retail investors John Chevedden, William and Kenneth Steiner, and James McRitchie are finding no shortage of targets for their campaigns to repeal supermajority voting provisions or grant shareholders the right to call special meetings or act by written consent. According to FactSet Research, two-thirds of Russell 3000 companies have some type of supermajority voting provisions, half prohibit shareholders from calling special meetings, and 72% prohibit shareholders from acting by written consent or require that it be unanimous.

Companies are readily responding to past majority votes or new filings of these proposals with their own resolutions, though they often contain restrictive covenants. It has become commonplace for issuers to adopt special meeting rights at higher share ownership thresholds than the 10% prescribed by the shareholder proponents and to adopt written consent rights with procedural safeguards, including ownership requirements to initiate a consent, limits on the business and timing of consents, and requiring that consents be solicited from all shareholders.[13] A number of companies are also opting to reduce, rather than totally eliminate, supermajority voting provisions.[14]

Needless to say, proponents have grown increasingly frustrated with the extent to which their proposals are being omitted for what they regard as corporate half-steps. In response to Nucor's no-action request, Chevedden argued to the SEC that the company's *de minimis* change to its supermajority vote requirement (from 70% to 66-2/3%) was a waste of corporate resources. Similarly, the AFL-CIO backed Kenneth Steiner's appeal to the SEC that excluding his written consent proposal in favor of a "watered-down" version by Fifth & Pacific would encourage more companies to employ this tactic. This would have "negative implications for the shareholder proposal process" by depriving investors of the opportunity to signal their support for a more robust consent right.

So far, the proponents do not appear to be retargeting companies that only partially implemented their proposals in the past. Last year, Chevedden sought to revoke the procedural safeguards in Home Depot's written consent provision, but his resolution received tepid (25.9%) support.

Separately, at least two companies this season have protested Chevedden's "blatant abuse" of Rule 14a-8 by making "proxy proposals by proxy," namely, submitting proxy proposals on behalf of another shareholder (such as McRitchie or Steiner) to companies in which he owns no stock. The companies argue that Rule 14a-8(h) only permits a shareholder to designate a representative for the limited purpose of presenting the shareholder's proposal at a shareholders' meeting. It does not allow a non-shareholder to submit resolutions for inclusion in companies' proxy statements. Ameriprise Financial was unable to obtain no-action relief from the SEC. Waste Connections is bypassing the no-action process and seeking a declaratory judgment from a federal court in Texas to exclude Chevedden's proposal. If the company prevails, other firms may resort to legal action where a proponent's ownership is in question.[15]

Political Spending

Shareholder proposals on corporate political activities may set record levels again this year, following

[13] According to FactSet Research, at Russell 3000 companies that permit shareholders to call special meetings, the most prevalent share ownership threshold is a majority (37% of firms), followed by 10% (25% of firms) and 25% (18% of firms). However, 69% of the companies that use a 10% threshold are in states where 10% is the statutory default (or 5% in the case of California). Companies that have adopted ownership requirements for initiating a written consent have typically conformed them to those for calling special meetings.

[14] Con-Way, FirstEnergy, Goodyear Tire & Rubber, Nucor, SAIC and Southern are among the firms taking this approach in 2013.

[15] National Fuel Gas also sought a judicial declaration from a federal court in New York that it did not have to include a proposal from the Massachusetts Pension Reserves Investment Management Board (PRIM) due to inadequate proof of ownership. PRIM subsequently withdrew its resolution and the company dismissed its lawsuit.

unprecedented campaign spending during the 2012 election cycle. The Center for Responsive Politics reports that independent or outside spending in federal elections increased nearly five-fold between 2010 and 2012. According to government watchdogs Demos.org and the U.S. Public Interest Research Group (PIRG), much of this increase was driven by "dark money non-profits": super PACs (which must disclose their donors) and trade associations and social welfare organizations (which are not required to disclose their donors).[16] These groups either did not exist (in the case of super PACs) or were not permitted to spend directly on elections prior to the 2010 *Citizens United* decision.

As a result, activists are stepping up their demands for more disclosure of corporate political donations, particularly payments made to intermediaries that are used for grassroots lobbying communications or other political advocacy. This year, filings of lobbying proposals (over 60 to date) are outpacing traditional disclosure resolutions developed by the Center for Political Accountability (CPA) (45 planned) due to an orchestrated campaign by Walden Asset Management, the American Federation of State, County and Municipal Employees (AFSCME), and a network of 65 institutional and retail investors. Some proposal variations specifically hone in on third-party donations (at Aetna and Valero Energy) or extend to employee-funded PAC contributions (at EMC and Western Union).[17]

Beyond proxy proposals, the New York State Common Retirement Fund (NYSCRF) has taken a more aggressive approach to obtain campaign spending information. In early January, New York State Comptroller Thomas DiNapoli sued Qualcomm in the Delaware Chancery Court for access to the company's internal records of political expenditures, including contributions to tax-exempt groups.[18] Although the suit was dropped after Qualcomm made the requested disclosures, books-and-records demands could become a new avenue for activists to obtain details of companies' political spending.

Business groups, for their part, continue to push back at potential SEC rulemaking mandating disclosure of corporate political spending.[19] In response to a rulemaking petition from a group of academics, the U.S. Chamber of Commerce and other trade associations point out that the principal advocates of increased transparency are union pension funds, social investment funds, and government pension funds controlled by elected officials with policy positions hostile to those of most companies. Their goal is not disclosure, but forcing companies to withdraw from the political debate altogether.[20] This is evident on a number of fronts. An internal memo of the left-leaning Media Matters Action Network outlined a three-year corporate transparency strategy, including tracking corporate funding of the conservative movement; creating "public-relations challenges" for companies that meddle in political campaigns; provoking "backlashes" among companies' shareholders, employees, customers, and the public at large; and launching shareholder resolution campaigns to prevent companies from making political expenditures.[21] Last year, progressive groups Common Cause and the U.S. PIRG sent letters to over 700 companies to sign a pledge renouncing the use of treasury funds or trade association dues for political purposes, while this year, social investment funds are filing more shareholder resolutions asking companies to cease their political

[16] See the report "Billion-Dollar Democracy" at http://www.uspirg.org/sites/pirg/files/reports/BillionDollarDemocracy.pdf.

[17] The proposals at Aetna (omitted) and Valero Energy ask them to amend their political contributions policies to annually disclose all payments made to tax-exempt organizations (other than charitable organizations not permitted to engage in lobbying as a substantial part of their activities) that are used to fund lobbying or grassroots lobbying communications or to make political contributions. A separate resolution at Aetna seeks stronger board oversight of political spending, including establishing specific criteria for making payments to intermediaries for political purposes and tasking the audit committee with evaluating related risks and ensuring compliance. The proposals at EMC and Western Union ask the companies to incorporate their corporate values into their corporate and PAC political and electioneering decisions and to report quarterly on such expenditures, including the rationale for any that are incongruent with the company's values.

[18] See http://www.blbglaw.com/cases/Qualcomm_data/qualcomm_complaint.pdf.

[19] The Office of Management and Budget's Unified Agenda indicates that the SEC plans to propose rules on disclosure of companies' political spending by April 2013. However, this schedule appears overly ambitious given the SEC's backlog of Dodd-Frank rulemaking.

[20] See http://www.sec.gov/comments/4-637/4637-1198.pdf and http://www.sec.gov/rules/petitions/2011/petn4-637.pdf.

[21] See http://www.scribd.com/doc/81500396/Media-Matters-Memo.

spending or to study the feasibility of adopting a no-spending policy.

Activists still have an uphill battle in convincing mainstream investors to back compulsory disclosure, as evidenced by waning support on shareholder proposals. Between 2011 and 2012, average support for the CPA resolutions fell from 32.8% to 28%, and average support for lobbying resolutions declined from 24.1% to 23.3%. Proposals advocating harsher actions—shareholder approval of or bans on corporate political spending—have fared even worse with only single-digit support.

Compensation Proposals

Submissions of pay-related shareholder resolutions have been on the upswing this year, but are quickly being scaled back due to withdrawals and omissions.

An ambitious campaign by the UBC to promote triennial SOP was aborted early on after meeting with resistance from issuers. The proposals, which were being filed at 45-50 companies, not only called for a three-year interval for pay votes, but also for separate advisory votes on executives' annual incentive pay, long-term incentive pay, and post-employment pay (retirement, severance and change-in-control benefits). The Carpenters sponsored 18 similar resolutions in 2009, which were ultimately withdrawn when Congress moved forward on mandatory SOP legislation. Ironically, most issuers that the UBC engaged at that time preferred a triennial over an annual frequency. The UBC maintains that investors simply cannot perform a thoughtful analysis of thousands of pay plans on an annual basis.

Shareholder proposals to restrict the accelerated vesting of executive equity awards following a change in control (CIC) are also getting whittled down due to omissions. This year, retail investors began sponsoring the resolutions, following last year's successful campaigns by union and public pension funds (the 13 proposals received 37.4% average support). However, the version being filed by Chevedden and Steiner, which would allow for *pro rata* vesting of awards if performance goals were met, has been excludable as vague and indefinite, as occurred with some proposals last year. To avoid similar no-action challenges, institutional proponents rephrased their 2013 resolutions so that any partial vesting of awards up to the time of the executive's termination following a CIC would be at the discretion of the compensation committee. Nevertheless, some issuers have still been able to omit the proposals where they conflict with a management resolution on the ballot to adopt or amend a stock incentive plan that contains CIC provisions.

Aside from wording changes, institutional activists have made an ideological shift in their targeting of accelerated vesting proposals. Whereas in the past they objected to single-trigger provisions and broad definitions of a CIC, they now argue that *any* accelerated vesting of equity awards can result in windfall payouts to executives unrelated to performance. As "best practice" examples, the proponents cite companies where there are no guaranteed benefits payable to executives upon a CIC or termination (Apple, Exxon Mobil, Intel, International Business Machines and Qualcomm) or where any partial vesting of equity awards is based on the executive's age and tenure (Chevron) or on performance conditions being satisfied (Hewlett-Packard).

Also making a strong comeback this year are resolutions requiring senior executives to retain a significant portion of stock from equity incentive programs (ranging from 25% to 75% of net after-tax shares) until reaching normal retirement age or termination. Sponsored primarily by organized labor and retail investors, this was the most predominant type of pay resolution in 2012 with 32 on ballots. However, even with the uniform backing of the proxy advisors, average support only reached 24.3%. Most of the targeted firms are large-cap companies that already have meaningful executive stock ownership requirements, though typically they are not as rigorous as what ISS recommends: 10 times base salary for the CEO, scaled down for other executives, or a retention ratio of 50% of net after-tax shares held through tenure with the company.

Union pension funds are introducing two new compensation proposals for 2013. The first, by the Utility Workers Union of America, asks companies to abolish the practice of benchmarking CEO pay to that of peer companies' CEOs. Citing a 2012 study by Charles Elson and Craig Ferrere, the proponent maintains that peer group benchmarking is to blame for spiraling executive compensation at U.S. companies.[22] Noteworthy is that some of the targeted firms (Consolidated Edison and NiSource) received over 90% support on SOP last year. The second proposal, which is being filed by the AFL-CIO at companies that have received low or failed SOP votes, requests specification of performance metrics for all equity compensation plans submitted to a shareholder vote in order to qualify for a tax deduction under IRS Section 162(m). This would give shareholders the opportunity to approve the actual performance formulas and payout schedules, as well as determine the extent to which pay and performance are aligned. Recipients of the proposal (Abercrombie & Fitch and Nabors Industries) are trying to omit it as vague and indefinite, substantially implemented, or in conflict with a management proposal to adopt a new incentive bonus plan.

Compensation Litigation

Apart from shareholder resolutions, an additional anxiety for issuers this year is the rise of pay-related lawsuits. Unlike past derivative suits, which alleged that directors breached their fiduciary duty if their SOP vote failed, the new class action suits are charging boards with inadequate proxy disclosure of compensation plans. The plaintiffs' law firms, primarily Farqui & Farqui, are filing the suits shortly after companies file their proxy statements with the intent to enjoin the SOP vote.[23] So far, few of these suits have been successful. Companies have pushed for quick dismissals, arguing that the purported disclosure omissions were immaterial and that their proxy statement disclosures satisfied all SEC requirements and were comparable to those provided by other companies.

Another wave of compensation-related litigation relates to Section 162(m) of the Internal Revenue Code, which limits the tax-deductibility of executive compensation in excess of $1 million unless it is performance-based. The shareholder derivative suits claim that directors breached their fiduciary duties, wasted corporate assets, or unjustly enriched executives by awarding non-deductible compensation, among other allegations. Although the case law around these suits is still evolving, a number of these complaints have been dismissed on the basis that boards have no general fiduciary duty to minimize taxes.

Additional Shareholder Campaigns

Other prominent shareholder endeavors this year, such as value maximization and climate change, are largely directed at companies in specific industries.

Financial institutions that have been deemed "too big to fail" are coming under fire for their low share-to-book valuations, which shareholder activists attribute to the risks associated with their investment banking and trading businesses. In a June 2012 *Wall Street Journal* editorial, former Morgan Stanley CEO Philip Purcell concluded that breaking up these firms would double or triple their shareholder value. In keeping with this assessment, the AFL-CIO, AFSCME, and Trillium Asset Management have filed resolutions at Bank of America, Citigroup, JPMorgan Chase, and Morgan Stanley to appoint independent board committees to explore ways of enhancing shareholder value, including a separation of their businesses.

Climate change resolutions are also reaching financial institutions which underwrite the fossil fuel industry. In the past, the SEC allowed financial firms to omit such resolutions as ordinary business. However, in a recent no-action letter to PNC Financial Services, the Commission reversed its previous rulings, in keeping with its 2010 guidance that companies should disclose their climate change risk because it had become a

[22] See "Executive Superstars, Peer Groups and Over-Compensation – Cause, Effect and Solution" at http://www.irrcinstitute.org/projects.php?project=60.

[23] According to the *Wall Street Journal*, Faruqi & Faruqi has filed over 15 lawsuits and announced over 50 investigations of corporate pay disclosures since March 2012. A recent memo by Pillsbury Winthrop Shaw Pittman LP indicated that the various plaintiffs' law firms have sued 24 companies and announced investigations of executive compensation at 73 companies. See http://www.lexology.com/library/detail.aspx?g=e96152d1-e82b-4b2e-b2b9-fa4f3b800087.

significant policy issue. JPMorgan Chase received a similar climate change proposal, but the proponents anticipate withdrawing it.

Environmental proposals overall are on the rise this year following the intense storms and record drought experienced in 2012. Investors working with Ceres, an advocate for sustainable business practices, have reportedly filed 91 resolutions at 78 companies—particularly in the extractive and utility industries--on topics ranging from reducing greenhouse gas emissions, increasing investments in renewable energy, decreasing water usage, and issuing sustainability reports.

Proponents, who are largely public pension funds, social investment funds, and religious orders, are shifting more attention this year to several key climate-related issues. Concerns over air and water pollution arising from hydraulic fracturing operations (a.k.a. "fracking") have resulted in more variations of proposals targeting oil and gas producers. These include minimizing the use of toxic chemicals in shale operations, limiting fugitive emissions of methane, and reducing the flaring of natural gas that is produced as a byproduct from oil wells. Also new are resolutions dealing with the exposure of companies' physical facilities—refineries, drill sites, data centers, and shipping operations—to extreme weather events and the costs of disaster risk management (filed at Chevron, Exxon Mobil, and Amazon.com).

Environmental activists are additionally expanding their advocacy of energy efficiency and clean energy strategies, not only at electric power and mining companies, but also in the information technology and real estate sectors, which are large energy users. This year, CalSTRS has joined the ranks of filers as a follow-up to letters it sent to 100 firms in mid-2012 seeking disclosure of their energy management practices. Although CalSTRS has only submitted six resolutions to date, one (at FLIR Systems) has already been deemed omissible as ordinary business.

Notwithstanding the high volume of filings, among all categories of shareholder resolutions, those dealing with environmental and social issues have the lowest probability of achieving majority support (only one proposal last year) and the highest probability of being withdrawn (43% in 2012, compared to 20% of governance resolutions and 14% of compensation resolutions). Considering the myriad of other challenges facing issuers this proxy season, that is at least one glint of relief.

For further information or questions, please contact:
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