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PROXY SEASON PREVIEW: 2014 SHAREHOLDER INITIATIVES

By Shirley Westcott **March 2014**

Overview

As proxy season begins anew, issuers will need to stay attuned to the shifting and sometimes disparate priorities of shareholder activists, proxy advisors, and institutional investors. With many governance best practices reaching a broader spectrum of companies, proponents are turning their attention to areas of unfinished business, while proxy advisors are scoping out future policy changes (see Alliance Advisors' December 2013 newsletter).

As no-action challenges and negotiated withdrawals continue to shake out the line-up of shareholder resolutions, several trends are emerging for this season:

Governance: This year may reach a low-water mark on the number of traditional governance proposals that come to a vote due to corporate adoptions of annual board elections, majority voting, and special meeting rights (see Table 1). Further hastening this trend are tougher proxy advisor policies on the implementation of majority-backed shareholder resolutions, as well as engagement efforts by mainstream investors. Proposals calling for independent board chairs will outpace other governance initiatives in sheer volume, but continue to fall short of broad-based support because of the growing prevalence of lead directors. The more controversial targets, such as JPMorgan Chase and Nabors Industries, are heading off repeat proxy showdowns by committing to ongoing dialogue with proponents or to a leadership split at the next CEO succession.

Compensation: Compensation proposals, which historically have been the purview of organized labor, are attracting increased patronage this year by retail activists affiliated with John Chevedden. In addition to perennial initiatives on executive stock retention and change-in-control payments, public debate over income inequality is stimulating a barrage of resolutions from Qube Investment Management on executive pay caps.

Environmental and Social (E&S): The mid-term elections are fueling another wave of proposals dealing with corporate lobbying and political spending, with more tie-ins to climate change policy, which has languished under the Obama Administration. Labor and social activists are also expanding their campaigns relating to human capital management—this year on worker and human rights in global supply chains, but eventually extending to internal pay disparity once new disclosure rules go into effect. Several new initiatives relating to corporate ethics, the aftermath of the financial crisis, and consumer data privacy have largely been withdrawn or omitted, or are surfacing as floor proposals ("spy lockout" at Apple).

Although there are unlikely to be any break-through issues this season, some shareholder initiatives bear monitoring to gauge overall investor reaction:

- **Proxy access** proposals are still being submitted sparingly, but increasingly directed at companies with no serious governance or performance problems.

- New proposals to **limit access to interim vote tallies** could capture significant support, particularly where backed by proxy advisory firms.

- **Operational activism** will be in high gear this year, driven by cash-flush hedge funds that can amass influential stakes in bigger targets. In addition to an escalation in proxy fights, weighty players like Carl Icahn are pitching their ideas directly to shareholders through non-binding shareholder resolutions.

- **Governance/nominating panels** will be on the hot seat over board composition (diversity and tenure) and the adoption of bylaws prohibiting "golden leash" payments or designating an exclusive forum for shareholder litigation.

Below are highlights of some of the key developments and shareholder proposals for the upcoming proxy season.

Majority Voting and Board Declassification

Corporate adoptions of annually elected boards and majority voting will gain momentum this season as a result of investor pressure and more rigorous proxy advisor policies. Beginning this year, Institutional Shareholder Services (ISS) will oppose directors who fail to implement these measures in the year following a successful shareholder proposal (based on a majority of votes cast), while Glass Lewis will hold full boards (rather than just governance committee members) accountable for not adopting declassification resolutions. Reform campaigns are also getting an added boost from mainstream investors such as Vanguard, which sent letters to 350 of its portfolio companies asking them to declassify their boards, adopt some form of majority voting, and allow holders of 25% of their shares to call special meetings.

At all market caps, director election standards are increasingly tilting from plurality to majority voting through longstanding efforts by union pension plans. According to FactSet Research, majority voting has reached 86% of S&P 500 firms, 53% of S&P 400 firms, and 26% of S&P 600 firms. This year, the United Brotherhood of Carpenters is targeting 27 of the S&P 500 outliers with shareholder proposals, while the California State Teachers' Retirement System (CalSTRS) is reporting a 93% success rate in the small- and mid-cap universe through engagement.

Running parallel to this is the Harvard Law School's Shareholder Rights Project (SRP) to draw down the number of large-cap companies with classified boards.[1] Already this year, 23 of its 31 target companies have agreed to comply by sponsoring management resolutions to declassify. If the SRP's 2014 campaign is fully successful, the number of staggered boards could drop by year-end from 12% to 8% of S&P 500 companies and from 17% to 11% of publicly traded Fortune 500 companies.

Notwithstanding the SRP's enthusiasm for this issue, not all shareholders are of the same mindset when it comes to classified boards. Davis Advisors, for example, sent an open letter to fellow Costco Wholesale shareholders defending the company's staggered board in light of the company's proven track record of shareholder stewardship and long-term value creation.[2] A recent academic study also challenges the prevailing view that classified boards entrench management.[3] The research found that firm value *increased* over a five-year period when companies shifted from annual director elections to staggered terms, particularly firms with sizable research and development expenses, more intangible assets, and lots of patents. The authors contend that longer tenures gave directors the freedom to pursue long-term, riskier investments without pressure from opportunistic shareholders.

Proxy Access

Now in their third year, shareholder proposals calling for the establishment of proxy access will be moderate in number but with an increasing shift towards a 3%/3-year ownership structure for nominating directors (see Table 2). These have had the strongest track record of investor support with one majority vote in 2014, four in 2013, and two in 2012.[4] Recent corporate adoptions—

[1] This year's participants in the SRP are the Florida State Board of Administration, Illinois State Board of Investment, North Carolina Department of State Treasurer, Ohio Public Employees Retirement System, and the Nathan Cummings Foundation.

[2] See http://www.sec.gov/Archives/edgar/data/909832/000119312514017934/d664041ddefa14a.htm.

[3] See *Staggered Boards and Firm Value, Revisited* by Martijn Cremers, Lubomir P. Litkov, and Simone P. Sepe at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2364165.

[4] Herein, majority support is calculated as the number of "for" votes as a percentage of "for" and "against" votes. The 2013 proxy access vote at Nabors Industries effectively failed because the company counts abstentions and broker non-votes in the denominator.

Hewlett-Packard, Western Union, and this year Verizon Communications and CenturyLink—have also adhered to this regime, which was proposed by the SEC in 2010.[5]

This year institutional proponents plan to extend their targeting of access resolutions beyond companies that have significant performance or governance failings. This may prove to be overly ambitious since many mainstream investors still regard proxy access as an extreme measure for promoting board accountability. Already this season, Walgreen defeated a 3%/3-year proposal by Change-to-Win (CtW) Investment Group, which reportedly dropped plans to submit another access resolution at JPMorgan Chase because it did not believe the measure would attract sufficient shareholder support. Nonetheless, union and public pension funds in particular have had a habit of doggedly pursuing the same companies on proxy access over the past 10 years (see Table 2).

Gadfly proponents are not giving up on their own version of proxy access with eligibility requirements tailored to retail investors: one or more shareholders collectively owning 1%-5% of the stock for two years, or alternatively, 25 or more shareholders individually owning $2,000 of stock and collectively owning 1%-5% for one year. As in the past, these can be expected to receive only marginal support.

Director Tenure

Investors are taking greater interest in board "refreshment" to promote new perspectives, objectivity and diversity in the boardroom. But rather than mandating term limits, which have failed to gain much support from shareholders, activists are linking lengthy service to director independence.

This year, Qube Investment Management is filing resolutions asking companies to adopt a policy that directors serving over 10 years be classified as non-independent. At the targeted companies, between one third and two thirds of the outside directors have tenures exceeding a decade.[6] Separately, CtW has threatened a vote "no" campaign at Skechers USA unless it overhauls its all-male, long-tenured board. CtW is reportedly in discussions with other companies with similarly insular boards.

The Council of Institutional Investors (CII) has also amended its corporate governance guidelines advising boards to take into account tenure in determining director independence—similar to the comply-or-explain approach of some European markets. CII argues that an extended period of board service can lead an outside director to think more like an insider.

Although the proxy advisors dislike arbitrary term or age limits for directors, it is unclear how they will react to this new initiative on tenure. ISS's fall policy survey revealed that 74% of investor respondents consider board service over 10 years to be problematic. Similarly, a recent academic study of S&P 1500 companies found that firm value peaks when average director tenure reaches nine years, and then drops off by as much as 10%.[7] As a result, ISS is considering future policy changes (2015 or beyond) to either classify long-tenured directors as non-independent or to recommend against nominating committee members if average board tenure and/or any individual director's tenure exceeds a specified level. In its recent updates to its QuickScore governance ratings, ISS appears to have settled on over nine years as an excessive director term.

Board Diversity

Aside from independence concerns, lengthy director tenures have been faulted for the slow progress in getting more women and minorities on corporate

[5] Small-cap firm Panhandle Oil & Gas also adopted a proxy access bylaw in December 2013 applicable to holders of 1% of the shares for five years. Only one director elected through proxy access may serve on the board at any given time and must be independent. Any shareholder requesting proxy access is restricted for one year from purchasing more than 10% of the stock or an additional 5% if the shareholder already owns 10%.

[6] Following successful dialogues, Qube Investment Management withdrew its director tenure resolutions at McDonald's, United Technologies, Scotia Bank, and Teck Resources. Its proposals at ACE and Eaton were omitted on technical grounds, and three others—at Consolidated Edison, Canadian National Railway, and IGM Financial—are pending.

[7] See *Zombie Boards: Board Tenure and Firm Performance* by Sterling Huang at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2302917.

boards. According to a 2013 Catalyst Census of Fortune 500 companies, the percentage of board seats held by women remained flat between 2012 (16.6%) and 2013 (16.9%). Among Russell 3000 companies, GMI Ratings found that 31.6% of directors have over 10 years of service, and over 90% of them are men.

The Thirty Percent Coalition's Institutional Investor Committee plans to accelerate its push for greater gender diversity on boards in 2014, including more engagement and shareholder resolutions.[8] Its goal is for women to hold 30% of U.S. public company board seats by the end of 2015. Issuers are often able to reach accords with proponents, including the withdrawal of board diversity resolutions (18 of the 25 filed in 2013 were withdrawn). Apple, for example, agreed to amend its nominating and corporate governance committee charter to explicitly include gender and race as factors in director selection. Proponents may also seek a public commitment to a diverse director candidate pool and a description of implementation plans, such as mandates to director search firms to recruit from less traditional venues, such as government or academia.

Proxy Voting Mechanics

Two relatively new shareholder resolutions dealing with proxy voting mechanics are being introduced this season in significant numbers: "enhanced confidential voting" and "uniform vote reporting" in measuring support for and opposition to a proposal.

The confidential voting proposals, primarily sponsored by John Chevedden, are in response to last year's controversy over interim vote reporting at JPMorgan Chase's annual meeting.[9] The resolution goes beyond standard ballot secrecy rules by prohibiting companies from receiving running vote tallies, except in director elections or contested proxy solicitations. Activists claim that issuers have an unfair advantage over shareholder proponents by their ability to track incoming votes and take steps to influence the outcome.[10]

Companies that have challenged the Chevedden proposal as vague and indefinite under Rule 14a-8(i)(3) have been able to exclude it.[11] However, the resolutions that have gone to a vote—at CenturyLink in 2013 and Whole Foods Market this year—have generated substantial support (39.6% and 42.2%, respectively) as well as ISS's endorsement. In a recent policy update, ISS clarified that it supports the underlying principle of the proposal because it would level the playing field within the proxy voting system. Issuers would not be hindered from monitoring preliminary votes for the purpose of establishing a quorum or to take appropriate actions during a proxy contest. Glass Lewis, in contrast, is opposing the proposals as overly restrictive because communications between issuers and shareholders prior to the annual meeting can lead to beneficial outcomes for both parties.

One of this year's targets—Verizon Communications—has responded by adopting a policy on interim vote tallies.[12] Under the policy, Verizon will authorize and

[8] Members of the Thirty Percent Coalition include the AFL-CIO; CalPERS; CalSTRS; the Comptrollers of New York State and New York City; the Treasurers of the States of Connecticut, Maryland, Massachusetts, Pennsylvania, Washington, and California; and various foundations, religious investors, and socially responsible investment funds.

[9] According to press reports, in the days prior to the JPMorgan Chase annual meeting, Broadridge Financial Solutions stopped providing vote tabulations to the shareholder sponsors of a resolution to separate the chairman and CEO positions. The decision was made at the request of the Securities Industry and Financial Markets Association (SIFMA), Wall Street's main lobbing group. Ultimately, JPMorgan Chase agreed to give the information directly to the proponents, as long as they signed a confidentiality agreement.

[10] The proponents cite a 2008 academic study which examined over 16,000 votes on management and shareholder resolutions between 1997 and 2004. The author found that management is overwhelmingly more likely to win votes by a small margin than to lose by a small margin due to its ability to obtain highly accurate voting information and act to influence the vote. See *Management Always Wins the Close Ones* by Yair Listokin at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=980695.

[11] One recipient of the confidential voting resolution, Omnicom, sought declaratory relief from a federal court to exclude the proposal, rather than requesting a no-action letter from the SEC. The case was dismissed. Several other companies (Chipotle Mexican Grill, EMC, and Express Scripts) have also resorted to litigation to omit other Chevedden proposals. Express Scripts recently won a favorable ruling from a U.S. district court in Missouri, while the EMC suit was dismissed.

[12] See Verizon's policy at http://www.verizon.com/investor/selectedpolicies.htm.

direct Broadridge Financial Solutions to provide non-public interim vote tallies to a qualifying shareholder who is conducting an exempt solicitation directed to holders of at least 50% of the outstanding shares regarding board elections or another voting matter. The shareholder must make a written request to the company and sign a confidentiality agreement.[13]

Separately, for a third consecutive year Investor Voice is advocating for fair and transparent vote counting whereby all matters brought to a shareholder vote would be decided be a simple majority of votes cast for and against (or withheld) and exclude abstentions. To avoid the high number of no-action challenges that occurred last year, the reworked proposal includes a carve-out so that the policy would not apply where shareholders have approved a higher vote threshold or where applicable laws or stock exchange regulations dictate otherwise.

Investor Voice takes issue with variations in the way votes are calculated for different types of proposals, and believes they should be harmonized with the formula used by the SEC in determining resubmission eligibility for shareholder proposals. At Nabors Industries' 2013 annual meeting, disputes arose over whether or not several high-profile shareholder resolutions had passed. Nabors counted both abstentions and broker non-votes against the ballot measures.

Although ISS rejected the three uniform voting resolutions on ballots last year, which averaged only 9.8% support, it has now adopted a formal case-by-case policy that broadly covers various aspects of proxy voting. In this instance, ISS is looking for clarity, consistency, and fairness in a company's vote standards and vote counting methodology; any recent controversies surrounding the company's proxy voting mechanics; and any unintended consequences that would result from implementing the proposal.

[13] Broadridge itself abandoned a change to its procedures on interim vote reporting, which was to take effect in early February. The change would have limited each party in a proxy fight to only receive vote updates pertaining to its own solicitation, unless the parties agreed to share information.

Political Spending and Climate Change

Shareholder proposals surrounding the disclosure of companies' political contributions will be in abundance again this year, particularly since this topic was excluded from the SEC's 2014 regulatory agenda. The Center for Political Accountability (CPA) and its fund partners plan to engage 60 companies on this issue ahead of proxy season, while a coalition of investors organized by Walden Asset Management and the American Federation of State, County and Municipal Employees (AFSCME) are sponsoring 48 resolutions on lobbying disclosure.

As part of a broader climate strategy, social and environmental activists are challenging companies' political activities on energy and climate change, particularly their involvement with certain trade associations and legislative groups whom the proponents feel are obstructing progress on climate-related legislation.[14] One new category of proposal this year asks fossil fuel and electric power companies to conduct a board-level review of their public policy advocacy related to climate policy, including through third parties such as the U.S. Chamber of Commerce, American Petroleum Institute, and National Association of Manufacturers (NAM). Concurrent proposals ask energy companies to assess how carbon emission regulations could impact their businesses and to improve their practices on hydraulic fracturing, flaring, and methane emissions.[15]

Another new initiative targets companies that have provided financial support to the American Legislative Exchange Council (ALEC), which writes and endorses model legislation for states based on free-market

[14] See *Raising the Bar – 2013-2014 Climate Strategy* at http://www.pbucc.org/documents/2013-2014%20Raising%20the%20Bar%20Climate%20Strategy%20-%209-17-13[2][1][2].pdf.

[15] Conservative groups, such as the National Center for Public Policy Research (NCPPR), have also been active on climate change, but their angle is to question companies' adherence to "global warming zealotry" over market-driven business strategies. Although NCPPR's resolution at Apple was met with a blistering retort from CEO Tim Cook, the group struck an agreement with General Electric to not undertake any energy savings or sustainability projects solely to address climate change concerns.

principles. The proposal calls for a review of lobbying activities at the federal, state, and local levels with the underlying intent of pressuring firms to renounce their affiliation with ALEC. The proponents withdrew one such resolution at Microsoft after the company expressed open opposition to ALEC's lobbying campaign against renewable energy.[16]

Separately, As You Sow and other environmental groups are targeting chemical and food companies with resolutions to desist from using corporate funds to influence any elections—specifically ballot initiatives which would require the labeling of genetically modified organisms (GMOS), such as Proposition 37 in California and I-522 in Washington State, both of which were defeated. Requests for outright bans on political spending have fared poorly in the past, averaging only single-digit support.

Pro-business groups continue to push back on disclosure campaigns, which they regard as a smokescreen for "name and shame" crusades to silence corporate speech. The Manhattan Institute, for instance, found that Fortune 250 companies that gave a majority of their political donations to support Republicans were more than twice as likely to be targeted with labor-sponsored shareholder proposals as those companies that gave a majority of their political contributions on behalf of Democrats.[17] In a letter to Fortune 500 companies last fall, the Chamber, Business Roundtable, and NAM also observed that voluntary corporate disclosures often lead to more demands from activists. The CPA, for example changes the methodology each year used in its CPA-Zicklin Index, which rates the top 200 S&P 500 companies on the quality of their disclosures. By continuously moving the goalposts, companies that previously had high scores are frequently retargeted with additional disclosure requests. Voluntary disclosures have also underpinned a new tool for activists—a searchable database created by the CPA and Center for Public Integrity on corporate donations to politically active nonprofit groups.[18]

To date, investors have not widely embraced enhanced political spending reporting, as evidenced by their modest support for shareholder resolutions: 31% on average for standard disclosure proposals and 24% on average for lobbying proposals over the past three years. Nevertheless, issuers should stay attentive to any shifts in their top holders' voting patterns on this subject. The CPA's 2013 Fund Votes Survey of the 40 largest U.S. mutual funds showed that some funds, such as Fidelity Investments and Federated Investors, began supporting some of the disclosure resolutions last year, while other funds, such as Russell Investments and TIAA-CREF, supported a fewer number of them than in the past.[19]

Human Rights

Recent legislative actions, such as the Dodd-Frank mandate on conflict minerals and California Transparency in Supply Chains Act, are drawing greater investor attention to the management of supply chains against human rights abuses.[20] This year, coalitions of social, religious, and labor proponents are stepping up their engagement and proposal filings urging multinational companies to conduct human rights risk assessments in their global supply chains. Among the targeted industries are the food, agriculture, and hospitality sectors, which are seen as particularly vulnerable to human trafficking and forced labor.[21] Shareholder proposals on this topic were first

[16] The proponents were willing to withdrawn the proposal at Pfizer if the company agreed to (1) use its influence with the leadership of organizations such as the U.S. Chamber of Commerce, Business Roundtable, and ALEC regarding their public policy positions, (2) publicly state that it does not support particular positions, actions, and lobbying stances of these organizations, and (3) expand its lobbying disclosures. Pfizer declined. See http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/christopherreynoldsfoundation120313-14a8.pdf.

[17] See http://www.proxymonitor.org/Forms/pmr_06.aspx.

[18] See http://www.publicintegrity.org/2014/01/11/14093/follow-corporate-cash-flow-nonprofits.

[19] See http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/8167.

[20] The California legislation requires companies doing business in the state with annual worldwide gross receipts exceeding $100 million to report on how they are evaluating and addressing risks of trafficking and slavery (forced labor, bonded labor, child labor, and sexual servitude) in their supply chains.

[21] According to a 2012 U.S. Department of Labor report, child and forced labor is particularly prevalent in the palm oil, apparel, seafood, and gold industries.

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introduced last year and received strong investor support (37.1% on average), as well as ISS's endorsement.

Operational Activism

As in 2013, traditional governance campaigns will once again be overshadowed by activism focused on the strategy and operations of corporations. Record amounts of money have poured into activist hedge funds, driven by their above-market returns and high success rate in pressing companies to return excess cash to shareholders, restructure their businesses, and replace ineffectual managements. According to ISS, proxy fight volume is on track to match or exceed last year's five-year high, with a dissident "win" rate (won or settled for board seats) having reached nearly 70%. Targets are also getting bigger, leaving no company immune. As reported by FactSet Research, insurgent campaigns aimed at companies with market caps in excess of $10 billion have tripled over the past five years.

Along with proxy fights, activists are deploying a rarely used tactic that was successful at Timken last year: bringing operational issues to a shareholder vote through non-binding resolutions.[22] But unlike the Timken proposal, which was sponsored by CalSTRS, such initiatives may be viewed more skeptically when originated by an activist hedge fund in search of a quick profit. Carl Icahn backed off his proposal at Apple to expand its $100 billion capital return program after encountering dissent from ISS and several vocal investors—including Warren Buffett, the New York City Comptroller, and the California Public Employees' Retirement System (CalPERS).

Restructuring proposals may fare better if perceived as value-enhancing rather than activist over-reach. Icahn's call for eBay to spin off its global payments unit has the added endorsement of PayPal co-founder Elon Musk and former COO David Sacks. Meanwhile, Starboard Value LP is proposing a shareholder vote on Darden Restaurant's plans to spin off of its Red Lobster chain. Starboard hopes to delay the transaction ahead of the September annual meeting in favor of breaking up more of the company.

Corporate Defenses and Bylaws

The surge in shareholder activism, merger-related litigation, and proxy fight activity in recent years has brought about new forms of protective measures and bylaws that will be under proxy advisor and investor scrutiny this year.

The decline of traditional defenses, such as classified boards, has prompted some issuers to strengthen their poison pills to guard against threats from activist hedge funds. According to FactSet Research, over half of the pills adopted in 2013 had low 10% triggers and included derivatives in the ownership calculation. New age variations are also on the rise, including "13D pills" that carry separate triggers for passive and activist investors (Air Products & Chemicals, Hertz Global Holdings, Safeway, and Sotheby's), and "tax pills" that restrict ownership changes above 5% in order to preserve net operating loss carry-forwards (J.C. Penney). But apart from rankling proxy advisors and shareholders, who object to overbearing pills, redesigned rights plans may have limited utility against hedge funds who are seeking a nominal stake to influence companies, not to acquire them.

Another measure that could have a chilling effect on proxy fights are restrictive director qualification bylaws. Controversial "golden leash" incentive payments in last year's proxy contests at Agrium and Hess prompted at least 35 companies to adopt bylaws that prohibit dissident groups from privately compensating their nominees in connection with their candidacy or service on the target company's board. Deeming the provisions overly broad, ISS and Glass Lewis have announced that they will recommend against boards or governance committee members that adopt such measures without shareholder approval. Early indications are that many investors also do not view these provisions favorably. Over a dozen companies have since repealed their bylaws, in many

[22] In 2013, CalSTRS and Relational Investors netted majority support for their resolution to separate Timken's businesses. In response, the company plans to spin off its steel unit later this year.

cases following outreach to their major shareholders.[23] Among them is Rockwell Automation, which had originally agreed with its top holders to put its bylaw to a shareholder vote in 2015. However, that still did not spare its directors a negative ISS recommendation and high withhold votes (27%-32%) at its February annual meeting. Other companies have adopted toned-down bylaws that only require disclosure of third-party incentive payments (C.R. Bard and CenturyLink) or bar them when they relate to director service rather than candidacy (Raymond James Financial).

Corporate adoptions of forum selection bylaws have also been on the upswing since the Delaware Chancery Court upheld their validity last June.[24] The provisions alleviate the costs and uncertainty of multi-jurisdictional litigation by requiring that derivative actions, shareholder class actions, and other intra-company disputes be litigated in a specified forum, usually Delaware. According to a recent academic study, merger litigation reached a record rate in 2013, though the proportion of suits brought in more than one state decreased from 51.8% in 2012 to 41.6% in 2013.[25] The proxy advisors generally dislike forum selection provisions, but Glass Lewis will go so far as to recommend against members of the governance committee for unilaterally adopting them. To date, investors have shown little objection to these bylaws, but issuers should monitor the views of their own shareholder bases. A recent vote on PTC's exclusive forum bylaw passed by only a narrow margin (55.3% of outstanding shares).

Bylaws permitting companies to hold virtual-only shareholders' meetings, which are allowed in 22 states, are similarly facing heat from some investors this year. Proposals filed at Bank of New York Mellon and PNC Financial Services Group, which adopted such bylaws last fall, urge the companies to continue holding in-person meetings and only use remote access as a supplement to broaden shareholder participation. Although the proxy advisors have no formal policies on this subject, they are likely to side with groups such as CII which believes electronic-only shareholder meetings would shield boards and managements from direct interaction with investors.

Looming Issues

This will be a relatively quiet year for new regulations relating to public company governance. However, two highly controversial issues that have been tabled or delayed by regulators—auditor rotation and CEO pay ratios—are still factoring into some of this year's shareholder advocacy.

Early this year, the Public Company Accounting Oversight Board (PCAOB) abandoned its three-year-old proposal to mandate auditor term limits, which had met with heavy resistance from the business community and Congress.[26] Nonetheless, ISS is considering future policy changes that would tie its recommendations on auditor ratification to auditor tenure, amounting to a *de facto* rotation rule. Meanwhile, the Carpenters, who called for a seven-year rotation of outside auditors two years ago, have taken their advocacy off-ballot. Through letter-writing and engagement, the Carpenters are now asking issuers to expand their disclosures on auditor independence, including the tenure and fees of the outside auditor, the process for selecting the lead audit partner, and any policy to rotate the audit firm.

Later this year, the SEC is expected to finalize a pay ratio disclosure rule, mandated by the Dodd-Frank Wall Street Reform and Protection Act, which would likely take effect in 2016. As proposed, companies would be required to disclose the ratio between the annual total

[23] Companies that have revoked their director qualification bylaws include Bob Evans Farms, Centene, C.R. Bard, Eastman Chemical, Halliburton, HollyFrontier, Insperity, International Game Technology, Invacare, Joy Global, Key Energy Services, Leggett & Platt, Marthon Oil, McGraw-Hill Financial, Schnitzer Steel Industries, Service International Corporation, Timken, and Whitewave Foods.

[24] According to Katten Muchin Rosenman LLP, over 140 companies adopted or announced plans to adopt exclusive forum bylaws between June and October 2013.

[25] See *Takeover Litigation in 2013* by Matthew D. Cain and Steven M. Davidoff at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2377001.

[26] The U.S. House of Representatives passed a bill last July (H.R. 1564, the "Audit Integrity and Job Protection Act") amending the Sarbanes-Oxley Act to prohibit the PCAOB from requiring public companies to use specific auditors or use different auditors on a rotating basis.

compensation of the CEO and the median annual total compensation of all other employees worldwide, including part-time, temporary, and seasonal workers. To minimize costs, companies will be permitted to use statistical sampling and reasonable estimates in calculating median worker pay, though they must disclose their methodology.

Some activists are getting out in front of the new rule with proposals suggesting benchmark pay differentials. This year, Qube Investment Management has filed over a dozen resolutions calling for either a vertical CEO pay ratio cap of 99 times the average worker's earnings or a simple gross pay cap of $5 million for each named executive officer. Although most are getting omitted on procedural grounds—a recurring problem across all of Qube's resolutions—strict pay caps have never sat well with investors or proxy advisors and have been overwhelmingly rejected in the past.[27]

Critics of the pay ratio rule question whether it will provide any meaningful information to investors at large. A recent survey on executive pay by Towers Watson and Alliance Advisors found that neither directors nor investors think it will help improve corporate pay models. CII similarly conceded that its members had mixed views about the value of the pay ratio to investors, noting that companies will need to put the number into some kind of context. Issuers should, in any case, stay apprised of how investors and proxy advisors plan to integrate pay ratios into their pay-for-performance models and evaluations of executive compensation. As with any new regulation, once the rule is finalized, companies should get an early start not only on the compliance aspects, but also the potential implications in proxy voting.

[27] Qube's benchmark of 99:1 also appears unrealistic based on current pay ratio statistics. According to data compiled by Bloomberg News from the U.S. Bureau of Labor Statistics (BLS) and the Bureau of Economic Analysis, the average multiple of CEO compensation to that of rank-and-file workers at S&P 500 companies stands at 204 times. The AFL-CIO's Executive Pay Watch puts the figure at 354 times. Using BLS data, ISS performed its own analysis across S&P 1500 companies and came up with a median ratio of CEO-to-average employee pay of 88:1 in 2012. The lowest ratios were in the software & services and semiconductor industries, and the highest ratios were in the retailing, food, beverage & tobacco and household & personal product industries.

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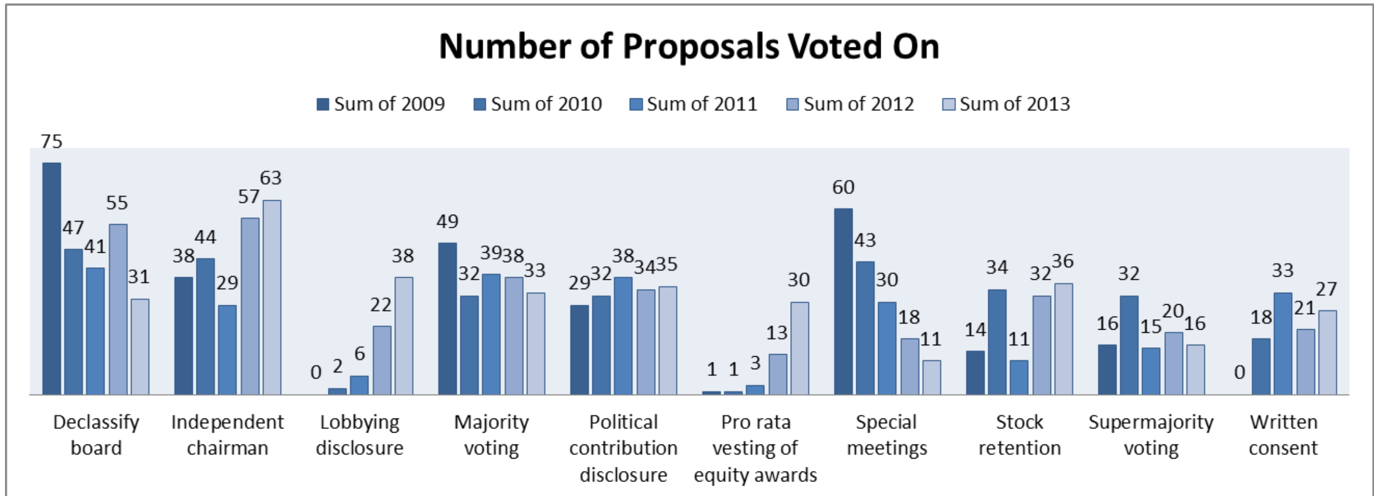
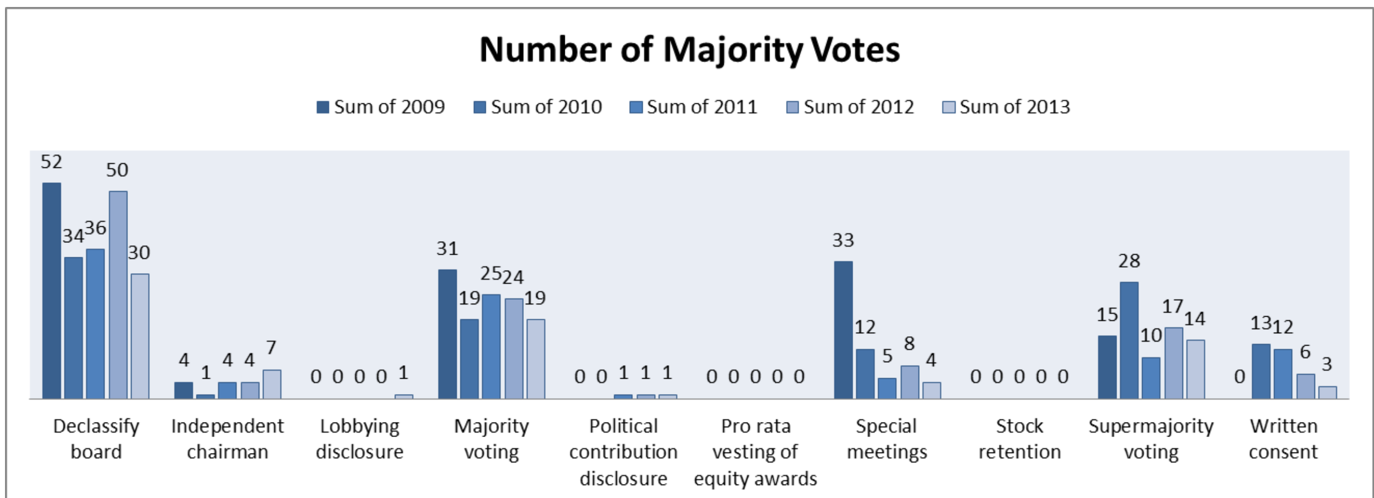
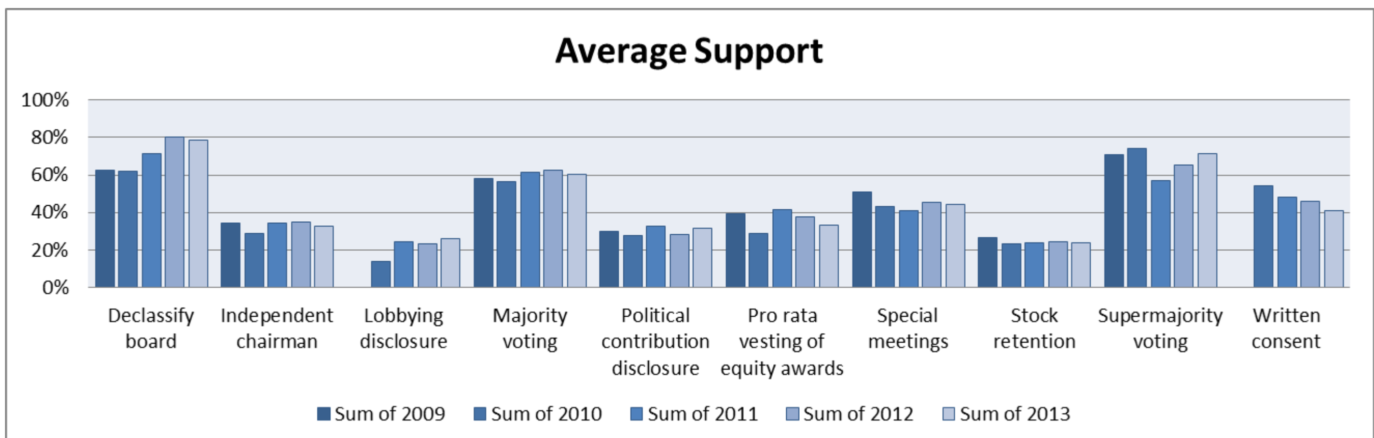
Table 1: Governance Proposal Trends







Voting support is based on "for" votes as a percentage of "for" and "against" votes.

Table 2: 2014 Proxy Access Proposals

Target Company	Proponent	Proposed Eligibility	Meeting Date	Result*	ISS Rec
Apple Inc.	James McRitchie	Holder(s) of 1%-5% of the shares for 2 years or 25 or more holders each owning for 1 year $2,000 of stock (and collectively 1%-5%).	28-Feb	4.3%	AGAINST
Bank of America Corp.	Harrington Investments	Holder(s) of 1%-5% of the shares for 2 years or 25 or more holders each owning for 1 year $2,000 of stock (and collectively 1%-5%).	7-May		
Boston Properties, Inc.	Miami Firefighters' Pension and Relief Fund and City of Philadelphia Public Employees Retirement System	3%/3-years	May		
Citigroup, Inc.	James McRitchie	Holder(s) of 1%-5% of the shares for 2 years or 25 or more holders each owning for 1 year $2,000 of stock (and collectively 1%-5%).	22-April		
International Business Machines Corp.	Qube Investment Management	3%/3-years	29-April	Omitted	
International Game Technology, Inc.	Steven Krol	3%/3 years	10-Mar	57.8%	FOR
Praxair, Inc.	Qube Investment Management	3%/3-years	22-April	Withdrawn	
SLM Corp.	Nathan Cummings Foundation	3%/3-years	25-Jun		
Walgreen Co.	CtW Investment Group	3%/3-years	8-Jan	43.4%	FOR
Wal-Mart Stores, Inc.	Hermes Equity Ownership Services Ltd.	3%/3 years	6-Jun		
Walt Disney Co.	Hermes Equity Ownership Services	3%/3-years	18-Mar		FOR

**Calculated as the number of "for" votes as a percentage of "for" and "against" votes.*

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