

2017 PROXY SEASON PREVIEW

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Overview

Against a backdrop of regulatory uncertainty, shareholder activists are pressing forward this spring with their efforts to promote governance reforms, improve transparency, and enhance shareholder rights through private ordering.

As in 2016, proxy access and environmental issues will dominate this year's shareholder proposal landscape, with each accounting for approximately 20% of the resolutions filed to date (see Table 1). However, relatively few of the proxy access proposals will make it to ballots due to negotiated withdrawals and omissions. The New York City Comptroller's office reported that it is on track to withdraw all but about 20 of its resolutions as a result of corporate adoptions, which now account for a significant majority of S&P 500 constituents. Retail investor resolutions, which largely seek to amend share aggregation limits in existing proxy access bylaws, fell flat after the SEC concluded that they were excludable on substantial implementation grounds.

Pronounced shifts in the voting policies and engagement priorities of major asset managers could impact voting outcomes on several key issues. Beginning this year, Fidelity Investments will start supporting shareholder and management resolutions to adopt proxy access with market standard features. BlackRock and State Street Global Advisors are also taking more aggressive stances on climate change and board diversity. Other investment firms are facing pressure to get on board by examining inconsistencies between their voting records and their public posture on matters such as climate change.

Other significant issues on the horizon include election spending and lobbying—particularly at the state level—along with proposals on workforce diversity, equitable pay, and fair employment practices in conflict zones,

many of which are showing up in bolder numbers this season. Proponents are also reviving topics not seen on ballots in several years, such as prescription drug pricing, virtual-only meetings, and access to preliminary vote results. However, most of these are not surviving no-action challenges.

Recent controversies have sparked several new resolutions dealing with employee incentive pay at major banks, the impact of North American pipelines on indigenous communities, and the dissemination of fake news on online platforms. Conservative groups are also taking on companies over employees' religious freedom rights and the risks of advertising on "politicized" news outlets, though their proposals are largely getting omitted. Meanwhile, Snap's contentious initial public offering (IPO) is fueling heightened investor scrutiny of multi-class voting structures and calls for stock exchanges and index providers to exclude no-vote companies from their listings.

For their part, companies are teeing up a second round of say-on-pay (SOP) frequency votes. Notwithstanding strong investor approval of executive compensation programs—which has been averaging over 90%—most firms are continuing to recommend an annual frequency rather than shift to a longer interval. A number of companies are also revisiting their provisions on director removal and shareholders' ability to amend the bylaws as a result of recent litigation and changes to proxy advisor policies.

Aside from annual meeting activity, this will be a transformative year on the public policy front as the Trump administration scales back burdensome regulations, including the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. However, early moves to dismantle rules on governance, compensation, and the environment are simply strengthening the resolve of shareholder activists to look to private

ordering to pursue their campaigns for corporate change.

Overall, this will prove to be a challenging year on a variety of fronts. Highlights of some of the key issues facing companies and investors in the upcoming months are discussed in more detail below.

Proxy Access

In advance of the 2017 annual meeting season, proxy access turned a corner when adoptions reached a majority of S&P 500 firms. In all, 420 companies have proxy access rights, with 77% following standard market parameters whereby up to 20 holders of 3% of the stock for three years may nominate 20% of the board, in most cases with a two-director minimum.¹

Many of the adoptions in recent months have been in response to the submission of shareholder proposals and a convergence of investor views on the issue. Most recently, Fidelity, which had previously opposed proxy access, amended its proxy voting guidelines for 2017 so that it will consider proposals case-by-case. Fidelity prefers a 3/3/20/20 access structure, but will support a 5% ownership threshold at small-cap companies.²

Now in the third year of its Boardroom Accountability Project, the NYC Comptroller's office reported in March that it submitted over 70 proxy access resolutions for 2017, though all but about 20 are expected to be withdrawn as a result of targeted companies agreeing to adopt bylaws with mainstream (3/3/20/20) access features.³ Consistent with prior

years, the NYC Pension Funds largely targeted S&P 500 firms on the basis of three criteria: little or no apparent gender or racial diversity on their boards, excessive CEO pay, or operating in carbon-intensive industries. This year's focus list also included companies with inadequate gender diversity in their C-suites, no disclosure of greenhouse gas (GHG) emissions, or other governance concerns. While the NYC Funds are still advocating a 3/3/25 access structure, this year's requests also include a two-director minimum.

Corporate gadflies John Chevedden, James McRitchie, Myra Young, and Kenneth Steiner continue to be active filers—accounting for over half of all submissions—but changed up their 2017 proxy access proposals to focus primarily on share aggregation limits. To date, 72% of their resolutions seek to amend current proxy access bylaws, and three-quarters of these are strictly to raise the nominating group size to 40 or 50 shareholders rather than to make multiple revisions. While none of the single-issue “fix-it” proposals have yet come to a vote, prior proposals designed to make proxy access available to small investors have fared poorly in the past, averaging less than 10% support.⁴ Early 2017 votes similarly show that investors are reluctant to tinker with secondary provisions in market standard proxy access bylaws, notwithstanding ISS support for the proposed changes (see Table 2).

As occurred last year, companies may omit resolutions for the initial adoption of proxy access on substantial implementation grounds if they institute a bylaw that addresses the proposal's essential objective—namely, a 3%/3-year eligibility requirement—even if other features deviate from the shareholder proposal. So far this year, some 17 of the retail investor resolutions have been excluded on this basis. Several others were withdrawn—at 3D Systems, Illumina, and Progenics Pharmaceuticals—because the proponents acknowledged that the companies' bylaws were a “baby

¹ A February 2017 report by the Council of Institutional Investors (CII) and Covington & Burling summarizes key provisions in the proxy access bylaws adopted through Dec. 31, 2016. See http://www.cii.org/files/publications/misc/02_02_17_proxy_access_private_ordering_final.pdf.

² See Fidelity's 2017 proxy voting guidelines at https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCO.pdf.

³ See As You Sow's Proxy Preview 2017 at <http://www.proxypreview.org/>.

⁴ The proposals advanced by individual investors in 2013 and 2014 advocated nominating groups as large as 50+ shareholders. The proxy advisors rejected all of these resolutions.

step” in the right direction.⁵ Noteworthy is that the “essential objective” reasoning was successful at Discover Financial Services, which adopted a standard 3/3/20/20 bylaw in response to a shareholder proposal that requested only one specific feature in the initial bylaw—a 40-shareholder aggregation limit—while leaving other parameters to the discretion of the board.

More problematic this year has been the SEC’s approach to “fix-it” proposals. As in 2016, those seeking multiple revisions to an existing proxy access bylaw have not been excludable under Rule 14a-8(i)(10) unless the targeted company implements at least a portion of the requested changes—the most critical being to reduce a 5% ownership threshold to 3%.⁶ However, the SEC staff has rendered varied decisions on proposals that solely wanted to raise the aggregation limit in company bylaws to 40 or 50 shareholders. Although most companies have been granted no-action relief on the basis of substantial implementation, in five cases it was initially denied. Three of the firms have since been permitted exclusion after requesting reconsideration.⁷ While the SEC’s reasoning is unclear, legal experts observe that many of the companies that successfully argued for omission presented details of their institutional shareholder base

to demonstrate that a higher aggregation limit would not materially impact the availability of proxy access.⁸

Notwithstanding the whirlwind of activity surrounding the adoption of proxy access, it is still unclear how the right will ultimately pan out in practice. Advocates insist that it will primarily provide leverage to make companies more responsive to investor concerns. Indeed, NYC Comptroller Scott Stringer credited proxy access for Exxon Mobil’s recent decision to appoint a climate scientist to the board—a longstanding demand by environmental activists. However, GAMCO Investors’ aborted 14a-11 nomination last fall at National Fuel Gas serves as a reminder to issuers to exercise care in crafting their proxy access bylaws, being mindful of their shareholder base.⁹ While most bylaws disqualify nominators who want to change or influence control of the corporation, it is essential that proxy access measures strike the right balance between usability and “abusability.”

⁵ McRitchie and Young also withdrew “fix-it” proposals at Costco Wholesale and Goldman Sachs. No reason was given for the withdrawals.

⁶ See the SEC’s no-action letters to Oshkosh and NVR at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/johncheveddenoshkosh110416-14a8.pdf> and <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/comptrollercitynyrecon032516-14a8.pdf>. Apple similarly revised its proxy access bylaw in advance of its 2017 annual meeting, including one change requested by the proponent—removing the minimum vote requirement for renomination. However, Apple was unable to omit the resolution as substantially implemented.

⁷ Citigroup, Target, and UnitedHealth Group were granted no-action relief after it was initially denied. The proponents have also asked the SEC to reconsider no-action responses which allowed exclusion of single issue fix-it proposals, but they have not been successful.

⁸ One company—Dun & Bradstreet—additionally amended its bylaw to raise the aggregation limit from 20 to 35 shareholders.

⁹ In recent months, several other Schedule 14Ns have been filed. One has been settled (Biopix), while the other two are at foreign-incorporated companies (MagicJack VocalTec and Paragon Offshore).

Diversity

Diversity initiatives are taking on a broader focus this year, encompassing both gender and ethnicity, not only in the boardroom but also within the general workforce. Progress has been steady but slow. According to a January 2017 study by the Investor Responsibility Research Center Institute (IRRCi) and Institutional Shareholder Services (ISS), women now hold 17.8% of S&P 1500 board seats—up from 11.8% in 2008—and minority directors hold 10.4% of board seats—up from 8% in 2008.¹⁰ Female representation in C-suites is similarly stark. Catalyst reports that across S&P 500 firms, women make up 5.8% of CEOs and 25.1% of executive and senior-level managers, but constitute 44.3% of all employees.¹¹

In view of this, shareholders are stepping up their diversity advocacy this year. In early March, BlackRock and State Street outlined their plans to drive greater gender diversity on boards through active dialogue and engagement with companies.¹² If progress is not made within a reasonable timeframe, they will use their proxy voting power to influence change by voting against chairs or members of nominating/governance committees. State Street plans to send letters to 700 Russell 3000, FTSE 350, and S&P/ASX 300 firms that have no women on their boards, and will give them a year to enact changes before taking action against their directors.

Shareholder proponents are also expanding their targets beyond boards with no gender or racial diversity to

those where women and minorities are underrepresented. As in past years, many of the resolutions are getting withdrawn as a result of company commitments to adopt robust recruitment policies and report on their progress in implementing them. A new proposal variation this year, coordinated by the Midwest Diversity Coalition and UAW Retiree Medical Benefits Trust, asks 11 companies to take the additional step of including qualified women and minorities in the candidate pool for every open board seat. According to a Wall Street Journal report last August, a number of companies—Ecolab, Johnson & Johnson, Nucor, Pinterest, Symantec, and Voya Financial—have already taken similar action by restricting their initial board candidate searches to women or by interviewing at least one woman candidate for each vacancy on the board.

Trillium Asset Management and other filers have ratcheted up their requests for workforce diversity reports this year—particularly at financial firms—which would tabulate employee data by race and gender across 10 employment categories and disclose company policies for increasing diversity in the workplace. Last year's resolutions averaged 27% support.

EEO-1 reporting is also the new format for reprised proposals from the Holy Land Principles organization, which seek a comparable breakdown between Israeli and Palestinian employees for the past three years at companies operating in Israel. Past resolutions asking companies to adopt the eight-point code of conduct generated only single-digit support, rendering them ineligible for resubmission. Although many of this year's resolutions have been similarly omitted, one company—Corning—agreed to sign on to the Holy Land Principles.

¹⁰ See the IRRCi/ISS study at <https://irrcinstitute.org/news/new-study-provides-comprehensive-hard-data-on-hot-topic-of-corporate-board-refreshment/>.

¹¹ See Catalyst's report at <http://www.catalyst.org/knowledge/women-sp-500-companies>.

¹² See BlackRock's engagement priorities for 2017-2018 at <https://www.blackrock.com/corporate/en-us/about-us/investment-stewardship/engagement-priorities>. See State Street's guidance on diversity at <https://www.ssga.com/investment-topics/environmental-social-governance/2017/guidance-on-enhancing-gender-diversity-on-boards.pdf>.

Economic Inequality

In conjunction with their diversity efforts, shareholder proponents are zeroing in on pay equity, doubling the number of resolutions submitted in 2016. After a successful campaign last year resulting in agreements with seven technology companies, Arjuna Capital, Pax World Management, and Zevin Asset Management (ZAM) have turned their attention to financial firms and retailers to disclose and remedy pay disparities among employees based on gender, race, or ethnicity. This effort coincides with a new EEO-1 reporting requirement from the Equal Employment Opportunity Commission (EEOC). Beginning in March 2018, many employers will have to provide summary compensation data along with diversity figures to assist in investigations of pay discrimination.¹³

Activists are also prodding companies to address the massive pay gap between CEOs and workers in advance of mandatory pay ratio disclosures, which take effect in 2018. Labor pension plans have introduced a new proposal at nine firms—three of which have been withdrawn—to take into account the pay grades and salary ranges of all employees when setting target amounts for CEO compensation. ZAM is additionally reprising its resolutions at CVS Health and TJX Companies to compare executive compensation with the median wages of employees over five-year intervals and determine whether there should be adjustments for downsizings or to stay within the 100x limit of the 2009 Excessive Pay Shareholder Approval Act. Last year's resolutions received only marginal support.

Separately, ZAM and Trillium are resuming their campaign to combat income inequality by urging retailers to adopt principles for minimum wage reform. This season, the proponents are taking a more nuanced approach by asking companies to take a stand on the

minimum wage debate rather than address their own pay practices. Despite the reformulation, the proposals continue to be omitted as ordinary business, as occurred in 2016.

Beyond pay, ZAM and a group of faith-based investors are addressing health inequality by pressing 11 pharmaceutical companies to explain their rationale for raising the prices of their most popular prescription drugs. Although all of the resolutions have been omitted as ordinary business, the proponents are simultaneously asking several of the firms to appoint an independent chairman or to report on their lobbying activities.

Compensation-Related Proposals

Last year's customer account fraud at Wells Fargo has put major banks on notice to review their clawback policies, risk controls, and employee incentive plans to discourage unethical behavior. Through letters, Change-to-Win Investment Group has called on five banks to review their workers' pay incentives and whether employees could face retaliation for whistleblowing. Harrington Investments is raising similar concerns in several proxy proposals, along with one that asks Citigroup and JPMorgan Chase to hold executives personally responsible for fines or penalties arising from activities which harm customers or pose systemic risk. Bart Naylor of Public Citizen is calling for more extreme measures by asking Wells Fargo and four other financial institutions to conduct breakup studies.

Wells Fargo is also facing a proposal from faith-based investors to review and report on:

- the root causes of the fraudulent activity,
- how it will impact customers, operations, reputation, and shareholder value, and
- steps taken to improve risk management and control practices.

¹³ See the revisions to EEO-1 reporting and summary pay data at <https://www.eeoc.gov/employers/eo1survey/2017survey-ganda.cfm>.

The company plans to release the results of its own internal investigation ahead of its April 25 annual meeting. Other resolutions were withdrawn after Wells Fargo addressed many of the concerns raised by the proponents, including reconstituting the board and management, clawing back executive pay, reforming risk controls, and changing the way it compensates its retail banking staff.

Separately, for a third year the AFL-CIO is circling back to four Wall Street banks on the issue of revolving door payments by asking them to prohibit the accelerated vesting of equity awards when executives voluntarily resign to enter government service. The resolutions averaged 21.5% support in 2015 and 23.7% in 2016.

Climate Change

With over 150 submissions to date, environmental issues represent the second largest category of shareholder proposals this year after proxy access—on par with 2016 though below the record 200 anticipated by Ceres. Over half are specific to climate change, a theme which also underpins some of the proposals on lobbying disclosure and executive compensation.

Spurred by strong investor support in 2016, proponents are strengthening their requests this year at Chevron and Exxon Mobil beyond reporting on how their businesses will be impacted by the 2015 Paris Agreement to limit global warming to 2 degrees Celsius. Social and faith-based investors are now seeking an assessment of how the companies can transition to a low-carbon economy by divesting their high-carbon assets or by acquiring firms with low-carbon assets or renewable energy. In a newly issued report, Chevron concluded that global efforts to curb GHG emissions will pose minimal risk to its operations because it has been investing in lower-cost assets which will not become stranded.¹⁴ Exxon, for its part, was

able to omit the resolution as duplicative of another ballot measure calling for a climate stress test.

Jantz Management and the Amalgamated Bank are similarly raising the bar on the reduction of GHG emissions by asking six firms—Amazon.com, CarMax, GameStop, Netflix, PayPal Holdings, and TJX Companies—to evaluate the potential for achieving net-zero emissions by 2030. Two earlier proposals at Apple and Deere, which demanded an action plan for achieving that target, were deemed too specific and omitted as ordinary business. Similar resolutions last year with ambitious emission reduction goals averaged only 7.7% support.

Finally, a new angle on environmental risk deals with the impact of North American pipeline projects on native American populations. Led by As You Sow, the resolutions—three of which have been withdrawn—ask several oil companies and financial institutions to report on the extent they consider the free, prior, and informed consent of indigenous communities in reviewing acquisitions or funding the pipelines. In conjunction with this, a coalition of 120 institutional investors have called on 17 U.S. and international banks to address or support the Standing Rock Sioux Tribe's request for a reroute of the Dakota Access Pipeline (DAPL) that avoids their treaty territory.¹⁵

¹⁴ See Chevron's report at <https://www.chevron.com/-/media/chevron/shared/documents/climate-risk-perspective.pdf>.

¹⁵ See the DAPL letter at <https://www.calpers.ca.gov/docs/investor-statement-to-banks-financing-dakota-access-pipeline.pdf>.

Mutual Fund Voting Practices

Votes on climate change proposals could get a boost in the years ahead if activists can persuade the largest mutual funds to back them. Two fund heavyweights—State Street and BlackRock—are already making strides in this direction.

State Street has made climate change one of its engagement priorities since 2014 and has dramatically shifted its proxy voting to support more climate-related shareholder resolutions—46% in 2016, compared to only 20% in 2015 and 13% in 2014.¹⁶ In this year’s annual letter to portfolio companies, State Street urged boards to disclose more about how they are addressing climate risk and integrating sustainability into their long-term strategies.¹⁷

BlackRock has similarly designated climate change as one of its engagement priorities for 2017-2018.¹⁸ Over the next year, it will be encouraging companies most exposed to climate risk—oil producers, miners, and real estate firms—to adopt the reporting framework of the Financial Stability Board’s Task Force on Climate-Related Disclosures (TCFD).¹⁹ It also expects the entire board of high risk companies to have “demonstrable fluency” in how climate risk affects the business. Where dialogue fails to deliver results, BlackRock will consider voting against directors and in favor of shareholder proposals that address its concerns.

Other investment firms are continuing to face pressure over incongruities between their voting records and

stated positions on climate change. In addition to BlackRock and JPMorgan Chase, which reached settlements with the proponents, Franklin Resources, T. Rowe Price Group, and Bank of New York Mellon were singled out this year for proxy voting review resolutions—not only on climate change but in some cases for also enabling high executive compensation.²⁰ As in 2016, the proposals are failing to gain traction, so far receiving only 3.5% support (compensation) and 4.5% support (climate change) at Franklin Resources.

For fund families that are not publicly traded, the proponents are exploring a new tack. Walden Asset Management has filed resolutions at select Vanguard funds requesting a board review and report of the funds’ proxy voting policies and practices related to climate change.²¹ According to Ceres, Vanguard was among 12 large fund companies that failed to back a single climate-related resolution in 2016. Walden’s proposals are for inclusion in the Vanguard funds’ next proxy statements, which could be years away since the funds are not required to hold an annual meeting unless they are making significant changes that require a vote by their investors.

¹⁶ See Ceres’ reports at <https://www.ceres.org/press/blog-posts/is-your-mutual-fund-company-taking-climate-change-seriously> and <http://www.ecowatch.com/is-your-mutual-fund-a-climate-change-denier-or-climate-champion-1882190571.html>.

¹⁷ See State Street’s letter at <https://www.ssga.com/investment-topics/environmental-social-governance/2017/Letter-and-ESG-Guidelines.pdf>.

¹⁸ See BlackRock’s guidelines on engagement on climate risk at <https://www.blackrock.com/corporate/en-us/literature/market-commentary/how-blackrock-investment-stewardship-engages-on-climate-risk-march2017.pdf>.

¹⁹ See the TCFD guidelines at <https://www.fsb-tcfd.org/publications/recommendations-report/>.

²⁰ See As You Sow’s report at <http://www.asyousow.org/wp-content/uploads/report/The-100-Most-Overpaid-CEOs-2017.pdf>.

²¹ See Walden’s resolution at <http://www.corpgov.net/wp-content/uploads/2016/12/Vanguard-walden-500-Index-Fund-cover-letter.pdf>.

Political Activities

After reaching a high-water mark in 2014, election spending proposals continue to decline—with only about 30 filed this year—due to improvements in corporate disclosures. According to the Center for Political Accountability (CPA), over 60% of S&P 500 firms now provide some level of reporting on their political contributions.²²

Conversely, companies have been less forthcoming about their expenditures on lobbying activities—particularly through trade associations and other third parties—which can have a significant influence on regulations and policies. For a fifth year, a coalition of 60 investors led by Walden and the American Federation of State, County and Municipal Employees (AFSCME) has submitted resolutions at 50 companies to disclose their federal and state lobbying amounts and payments to intermediaries used for indirect lobbying. Most are resubmissions and focus on sectors that spend the most on lobbying—defense, pharmaceuticals, energy, finance, and telecommunications.

A newly released study by the IRRCi and the Sustainable Investments Institute (Si2) points to another gap in corporate disclosures: expenditures on political lobbying at the state level.²³ While there exists considerable information available at the federal level, only about half of states mandate any sort of lobbying disclosure and voluntary disclosures on company websites are nearly non-existent. This lack of transparency is raising concerns among investors because state officials are increasingly taking on major policymaking.

Other political issues cropping up include a revival of “say on political spending” proposals. Submitted by NorthStar Asset Management, the resolution asks

Home Depot and Intel to provide shareholders with an advisory vote on the company’s and PAC’s electioneering and political contributions anticipated for the forthcoming year, along with an analysis of their congruency to company values. Similar proposals sponsored by James Mackie in 2014 averaged only 3.7% support.

On the conservative side, the National Center for Public Policy Research (NCPPr) is taking aim at companies that operate or advertise on “politicized” news outlets that advance specific political agendas and promote certain candidates for public office. NCPPr maintains that financial support of such organizations constitutes a form of corporate political spending, and exposes operators and advertisers to backlash and even boycotts. So far, most of the political risk exposure proposals have been omitted as ordinary business.

Concerns over media influence in the 2016 elections are also extending to the dissemination of “fake news,” hoaxes, and hate speech on social media sites. Arjuna Capital and Baldwin Brothers have introduced a new proposal at Facebook and Alphabet (the parent of Google) to evaluate the impact that fabricated content is having on their business models and society at large, and to report on the steps they are taking to filter posts, ads, and spamming without impeding free speech. The two Internet giants are already participating in collaborative initiatives in France and Germany, ahead of their respective presidential elections, aimed at combating the spread of disinformation online.

²² See the CPA report at

http://files.politicalaccountability.net/index/2016_Index.pdf.

²³ See the ICCRi/Si2 report at <https://irrcinstitute.org/reports/how-leading-u-s-corporations-govern-and-spend-on-state-lobbying/>.

Corporate Bylaws

A 2017 ISS policy change is prompting a number of companies to revisit their provisions relating to shareholders' ability to adopt, amend or repeal corporate bylaws. Beginning this year, ISS will recommend against governance committee members if they have placed "undue" restrictions on shareholders' ability to submit binding resolutions—either an outright prohibition or requiring stock ownership and time holding requirements in excess of Rule 14a-8 (\$2,000 of stock held for one year) to submit such proposals. The negative recommendations will be ongoing until the restrictions are repealed. In complying with this policy, ISS expects issuers to permit a majority of shares, rather than a supermajority, to approve bylaw revisions. ISS also clarified in a recent FAQ that the policy does not apply to open- or closed-end funds or to U.S. companies incorporated offshore.²⁴

ISS's new guideline mainly affects companies incorporated in states such as Maryland and Indiana where by default boards have the exclusive authority to alter the bylaws. To date, at least five corporations—Anthem, Cyrusone, Hanesbrands, Walker & Dunlop, and Xylem—and 18 real estate investment trusts have modified their bylaws or are presenting charter amendments this year to grant shareholders the concurrent right to amend the bylaws.

Aside from ISS's policy change, companies incorporated in Delaware may need to review their director removal provisions. In a January decision (*Frechter v. Zier*), the Delaware Court of Chancery struck down a clause in Nutrisystem's bylaws which required a supermajority shareholder vote to remove directors. Nutrisystem's director removal provision drew attention following a 2015 Chancery Court ruling (*In re Vaalco Energy, Inc. Stockholder Litigation*)

which held that under Delaware law shareholders may remove directors with or without cause by a majority vote unless the board is classified or directors are elected by cumulative voting. Nutrisystem dropped the "for cause only" provision in its bylaws, but retained the two-thirds approval requirement. According to SharkRepellent, 10% of S&P 500 companies still have supermajority requirements to remove directors.

Dual-Class Stock

Companies with multi-class capital structures and unequal voting rights have come under increasing fire from investors and proxy advisors following Snap's controversial decision to sell only non-voting shares in its recent IPO. Out of concern that other companies could follow suit, CII members plan to lobby major U.S. stock exchanges to prohibit companies from listing with non-voting shares or at least require a reasonable sunset on differential voting rights. They have also approached index providers S&P Dow Jones, MSCI, and FTSE Russell to exclude Snap and other new non-vote companies from their benchmarks.

Dual-class structures also feature in a new ISS policy for 2017. If adopted prior to or in connection with an IPO, ISS will recommend against individual directors, committee members, or the full board (except new nominees)—potentially on a continued basis—unless there is a reasonable sunset on the provision or until the provision is unwound.²⁵ According to ISS, nearly 6% of S&P 1500 companies have a dual-class structure.

²⁴ See ISS's February 2017 FAQ at <https://www.issgovernance.com/file/policy/us-policies-and-procedures-faq-feb-2017.pdf>. ISS has identified fewer than 300 companies that prohibit shareholders from submitting binding shareholder resolutions.

²⁵ According to Stanford University's Rock Center on Corporate Governance, at least 16 technology companies have adopted sunset provisions that abolish dual-class shares by a certain date.

Say on Pay Frequency

SOP frequency votes are returning to ballots this year at companies that held their last frequency vote in 2011. Once again, most boards are recommending annual votes, in line with the preferences of proxy advisors and many investors. Nevertheless, issuers should be attentive to any changes in their investors' voting policies. For example, Dimensional Fund Advisors changed its guidelines for 2017 to support triennial, rather than annual, pay votes.²⁶

According to a November 2016 report by Willis Towers Watson, 82% of Russell 3000 companies have been holding annual frequency votes, and the trend is expected to continue going forward.²⁷ Of the Russell 3000 companies holding first quarter annual meetings, 83% recommended annual votes. Only 13% recommended triennial votes, and these were invariably at firms with a significant shareholder, sizable insider ownership, or where shareholders approved a three-year frequency in 2011. None of the boards recommended a biennial frequency, and 4% made no recommendation at all. To date, only one company has recommended a longer pay interval than what is currently in place—National Fuel Gas, whose shareholders narrowly backed annual over triennial SOP votes in 2011 and again in 2017. Shareholders of INTL FCStone, Mitek Systems, and Super Micro Computer similarly approved annual over triennial votes by a narrow margin this year, even though the companies had recommended maintaining their three-year frequencies.

²⁶ See Dimensional's 2017 guidelines at <https://eu.dimensional.com/en/about-us/corporate-governance>.

²⁷ See the Willis Towers Watson report at <https://www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2016/Executive-Compensation-Bulletin-When-it-comes-to-say-on-pay-whats-the-right-frequency>.

Regulatory Reform

The Trump administration's pledge to scale back Dodd-Frank will likely upend various governance and compensation measures contained in the existing law. However, new legislation is not expected to be enacted until mid-2017 or later due to other Congressional priorities—the budget, tax reform, and repealing and replacing the Affordable Care Act.

As a starting point, in early February, Acting SEC Chair Michael Piowar directed SEC staff to reconsider implementation of the pay ratio rule and requested public comments by March 23 on any “unexpected challenges” issuers have experienced in preparing for compliance. Based on feedback, staff could delay implementation of the rule or provide additional guidance or relief. A week earlier, Piowar petitioned a similar review and comment period of the conflict minerals rule, which requires companies to disclose whether their products contain minerals mined from the war-torn Democratic Republic of the Congo.²⁸

Congressional lawmakers plan to introduce a new version of the 2016 Financial CHOICE Act (dubbed CHOICE Act 2.0) this spring, which is designed to repeal and replace Dodd-Frank. According to a memo by House Financial Services Committee Chairman Jeb Hensarling (R-Texas), the proposed changes include prohibiting the SEC from promulgating a rule on universal proxy ballots and modernizing the shareholder proposal and resubmission thresholds for inflation.²⁹ Business organizations have long advocated for changes to the shareholder proposal

²⁸ See the comments submitted on the pay ratio rule at <https://www.sec.gov/comments/pay-ratio-statement/payratiostatement.htm> and on the conflict minerals rule at <https://www.sec.gov/comments/statement-013117/statement013117.htm>.

²⁹ Under the current rules, an investor must hold at least \$2,000 of stock or 1% of the outstanding shares, whichever is less, for one year to submit a proposal. A shareholder proposal may be excluded if during the preceding five years it received on the last submission less than 3% of the vote if proposed once, less than 6% of the vote if proposed twice, and less than 10% of the vote if proposed three or more times.

process, which they feel is dominated by a few individuals and special interest groups.³⁰

Other changes relating to governance and executive compensation that were included in the 2016 Financial CHOICE Act could appear in this year's legislation. These include a full repeal of the following:

- the pay ratio rule,
- the authorization for the SEC to adopt proxy access rules,
- the requirement for disclosure of employee and director hedging, and
- the prohibition on certain incentive-based compensation by covered institutions.

The 2016 Act additionally limited the scope of the clawback rule and amended the SOP frequency requirement so that pay votes would only need to be held in a year in which there had been a material change in compensation. The bill further required that proxy advisors register with the SEC and disclose conflicts of interest.

One Dodd-Frank provision that will likely remain untouched is SOP because of its popularity with investors. It has also benefited issuers by shielding directors from negative votes when there are pay concerns, fostering engagement, and reducing investor reliance on proxy advisor recommendations.³¹

³⁰ See the Business Roundtable's "Top Regulations of Concern" at <https://businessroundtable.org/sites/default/files/Regulations%20of%20Concern%20Letter%20and%20List%20170222.pdf> and its recommendations for modernizing the shareholder proposal process at <http://businessroundtable.org/resources/responsible-shareholder-engagement-long-term-value-creation>. According to the Manhattan Institute's Proxy Monitor database, three investors and their families—Chevedden, McRitchie, and Steiner—accounted for about one-fifth of shareholder proposals at Fortune 250 companies in 2016.

³¹ A Proxy Insight report found diminishing congruency in recent years between the votes of 10 large institutional investors and

Outlook

At this stage, it remains uncertain how the Trump administration's policies and regulatory rollbacks will shape shareholder advocacy going forward since most of this year's resolutions were filed prior to the 2016 election. Some activists are already reaching out to corporations to ascertain how they are preparing for regulatory changes, their preferred policy outcomes, and how they are communicating their priorities to policymakers. Others are pushing back against more troubling prospects, such as stricter 14a-8 eligibility requirements, by appealing directly to administration officials.³²

Depending on the nature and pace of reforms, next year's proxy season could look very different. As the year moves ahead, Alliance Advisors will keep issuers apprised of key developments as they materialize.

negative proxy advisor recommendations on SOP. See <https://corpgov.law.harvard.edu/2017/02/02/are-top-investors-listening-to-proxy-advisors-on-pay/>.

³² See the March letter from five investor groups to National Economic Council Director Gary Cohn at http://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_15_17%20-%20Letter%20to%20Gary%20Cohn%20-%2014a-8%20Shareholder%20Proposal%20Process.pdf.

Table 1: 2016 & 2017 Shareholder Proposals

Governance Proposals	2016 Submitted	2016 Voted On ¹	2016 Majority Votes ²	2016 Average Support ²	2017 Submitted	2017 Voted On ¹	2017 Majority Votes ²	2017 Average Support ²
Declassify board	17	7	6	81.2%	7	0	0	
Director removal	2	2	0	9.0%	0	0	0	
Majority voting	23	20	17	76.5%	5	0	0	
Proxy access	216	84	42	50.5%	163	8	1	36.5%
Poison pill	2	1	1	69.7%	2	0	0	
Cumulative voting	1	1	0	10.9%	2	0	0	
Enhanced confidential voting	0	0	0		15	0	0	
Virtual meetings	0	0	0		4	0	0	
Supermajority voting	29	16	10	59.6%	12	0	0	
Voting requirements	11	8	0	7.7%	9	1	0	3.2%
Dual-class stock	13	12	0	27.5%	6	1	0	12.4%
Special meetings	22	19	4	41.8%	15	0	0	
Written consent	19	17	1	41.3%	10	1	0	36.3%
Amend bylaws	4	2	1	49.2%	2	0	0	
Other anti-takeover	2	2	2	70.6%	0	0	0	
Independent chairman	61	50	1	30.7%	33	3	0	31.4%
Lead director	0	0	0		1	0	0	
Board independence, tenure and size	4	1	0	35.6%	1	0	0	
Auditor tenure	15	0	0		0	0	0	
Reincorporate to Delaware	0	0	0		1	0	0	
Maximize value	14	9	1	26.8%	8	0	0	
Stock repurchases, dividends	19	17	0	3.7%	4	1	0	3.6%
Miscellaneous	19	4	2	45.8%	14	0	0	
Total Governance	493	272	88		314	15	1	

Compensation Proposals	2016 Submitted	2016 Voted On ¹	2016 Majority Votes ²	2016 Average Support ²	2017 Submitted	2017 Voted On ¹	2017 Majority Votes ²	2017 Average Support ²
Severance pay	4	4	1	36.0%	1	0		
Accelerated vesting of equity awards	17	15	0	31.6%	4	0		
Revolving door payments	6	5	0	23.7%	5	0		
Clawbacks	6	6	0	14.3%	6	0		
Retention of equity awards	13	12	0	17.6%	3	1		24.2%
Performance-based awards	1	1	0	6.7%	0	0		
Performance metrics	6	4	0	16.6%	0	0		
Pay disparity and ratios	26	7	1	12.8%	37	1		2.2%
Pay caps	3	1	0	2.8%	1	0		
Link pay to social issues	14	9	0	8.4%	10	1		23.1%
Proxy policy congruency - compensation	2	1	0	4.4%	3	1		3.5%
Miscellaneous compensation	7	1	0	0.6%	10	0		
Total Compensation	105	66	2		80	4	0	

E&S Proposals	2016 Submitted	2016 Voted On ¹	2016 Majority Votes ²	2016 Average Support ²	2017 Submitted	2017 Voted On ¹	2017 Majority Votes ²	2017 Average Support ²
Animal welfare	8	4	1	27.9%	5	1	0	24.3%
Board diversity	33	9	2	24.8%	35	2	0	3.7%
Charitable contributions	1	0	0		4	1	0	2.2%
Environmental	155	85	2		153	5	0	
Coal	0	0	0		2	0	0	
Hydraulic fracturing	6	4	0	20.7%	3	0	0	
Fugitive methane	13	5	1	32.0%	12	0	0	
Environmental impact - water	7	2	0	19.8%	3	1	0	14.7%
Climate change report	25	19	0	28.2%	27	0	0	
GHG emissions reduction	20	11	0	20.8%	22	1	0	34.0%
Finance and climate change	0	0	0		4	0	0	
Energy efficiency and renewable energy	26	10	0	24.8%	13	0	0	
Oil and gas transport risks	0	0	0		1	0	0	
Nuclear	1	1	0	4.3%	1	0	0	
Miscellaneous climate change	0	0	0		1	0	0	
Palm oil and deforestation	6	2	0	24.6%	7	0	0	
GMOs	3	0	0		0	0	0	
Nanomaterials	3	1	0	3.8%	2	0	0	
Recycling	11	7	0	19.9%	15	1	0	30.4%
Toxic substances	5	2	0	7.1%	6	1	0	5.5%
Board environmental risk committee	2	1	0	6.5%	1	0	0	
Director with environmental expertise	3	3	0	19.6%	4	0	0	
Other - environmental	3	0	0	28.1%	0	0	0	
Sustainability report	18	15	1	31.8%	21	0	0	
Board sustainability committee	0	0	0		2	0	0	
Proxy policy congruency - climate change	3	2	0	6.5%	6	1	0	4.5%
Employment/discrimination	18	8	1		36	0	0	
EEO report	7	4	0	27.0%	13	0	0	
Miscellaneous employment/discrimination	4	3	0	4.6%	6	0	0	
EEO - conservative view	1	0	0		8	0	0	
EEO - sexual orientation	6	1	1	54.7%	8	0	0	
Proxy policy congruency - non-discrimination	0	0	0		1	0	0	

E&S Proposals	2016 Submitted	2016 Voted On ¹	2016 Majority Votes ²	2016 Average Support ²	2017 Submitted	2017 Voted On ¹	2017 Majority Votes ²	2017 Average Support ²
Finance	4	1	0		5	0	0	
Tax risk and policy	2	1	0	4.2%	0	0	0	
Student loans	0	0	0		1	0	0	
Business standards	0	0	0		4	0	0	
Indemnification	1	0	0		0	0	0	
Miscellaneous finance	1	0	0		0	0	0	
Health	11	2	0		22	1	0	
Health - conservative	1	0	0		0	0	0	
Drug pricing	1	0	0		11	0	0	
Childhood obesity	3	0	0		0	0	0	
Board expertise - product safety	0	0	0		2	0	0	
Antibiotics and factory farms	5	2	0	17.7%	7	1	0	31.5%
Miscellaneous health	1	0	0		2	0	0	
Human rights	61	35	0		55	0	0	
Country selection/divestiture - conservative	5	5	0	2.1%	3	0	0	
Country selection/divestiture	8	4	0	3.8%	2	0	0	
Holy Land principles	9	9	0	3.9%	21	0	0	
Human trafficking	5	0	0		1	0	0	
Human Rights Mediation/Tobacco workers	8	6	0	4.4%	2	0	0	
Code of conduct	1	1	0	4.0%		0	0	
Vendor code of conduct and human rights in supply chain	8	2	0	25.1%	6	0	0	
Worker safety	6	4	0	17.3%	3	0	0	
Human right to water	0	0	0		3	0	0	
Internet and phone privacy, net neutrality, Internet affordability	4	1	0	11.0%	5	0	0	
Board committee on human rights	3	2	0	2.1%	1	0	0	
Director with human rights expertise	0	0	0		1	0	0	
Prison communications/inmate rights	2	1	0	21.5%	2	0	0	
Indigenous people	0	0	0		5	0	0	
Miscellaneous human rights	2	0	0			0	0	
Military sales	1	1	0	6.0%	1	0	0	
Political	114	76	2		96	5	0	
Political - conservative	2	0	0		10	0	0	
Grassroots lobbying	53	43	0	24.6%	49	4	0	29.3%

E&S Proposals	2016 Submitted	2016 Voted On ¹	2016 Majority Votes ²	2016 Average Support ²	2017 Submitted	2017 Voted On ¹	2017 Majority Votes ²	2017 Average Support ²
Indirect Lobbying	4	2	0	17.6%	1	0	0	
Public policy advocacy	5	1	0	21.2%	2	0	0	
Incorporate values	2	2	0	6.5%	0	0	0	
Incorporate values - conservative	5	3	0	4.1%	0	0	0	
Contributions - CPA	37	21	2	32.1%	28	1	0	40.3%
Non-deductible political expenditures	6	4	0	36.3%	4	0	0	
Advisory vote on political spending	0	0	0		2	0	0	
Tobacco	3	2	0		5	0	0	
Tobacco advertising and education	0	0	0		2	0	0	
Teen smoking (smoke-free movies)	0	0	0		1	0	0	
E-cigarettes	2	1	0	6.6%	0	0	0	
Miscellaneous tobacco	1	1	0	18.2%	2	0	0	
Firearms	3	1	0	8.2%	0	0	0	
Total Environmental & Social	412	224	8		417	15	0	
Total Proposals (All)	1,010	562	98		811	34	1	

Source: SEC filings, proponent websites, and media reports.

1. Includes floor proposals; excludes proposals on ballots that were not presented or were withdrawn before the annual meeting. 2016 figures are for the full year and 2017 figures are as of March 28, 2017.
2. Based on votes FOR as a percentage of votes FOR and AGAINST.

Table 2: 2017 Proxy Access Votes (through March)

Adopt Proxy Access	Proponent	2016 Vote ¹						2017 Meeting Date	2017 Vote ¹
Nuance Communications, Inc. ²	Kenneth Steiner							30-Jan	89.5%
Tyson Foods, Inc.								9-Feb	21.7%

Amend Proxy Access Bylaw	Proponent	2016 Vote ¹	Date Bylaw Adopted	Owner-ship %	# Holders	Owner-ship Years	# of Nominees	2017 Meeting Date	2017 Vote ¹
Apple, Inc. ³	James McRitchie	32.7%	21-Dec-15	3%	20	3	20%	28-Feb	31.9%
QUALCOMM, Inc.	James McRitchie	46.9%	7-Dec-15	3%	20	3	2 directors or 20%	7-Mar	31.7%
Starbucks Corp.	James McRitchie	57.4%	13-Sep-16	3%	20	3	2 directors or 20%	22-Mar	28.3%
Walgreens Boots Alliance, Inc.	John Chevedden		14-Oct-15	3%	20	3	20%	26-Jan	25.4%
Walt Disney Co.	James McRitchie		28-Jun-16	3%	20	3	20%	8-Mar	26.9%
Whole Foods Market, Inc.	James McRitchie	39.8%	26-Jun-16	3%	20	3	20%	17-Feb	36.6%

Source: SEC filings

1. Based on FOR votes as a percentage of FOR and AGAINST votes.
2. The Nuance Communications board made no recommendation on the proposal.
3. Apple amended its bylaw on Dec. 13, 2016, to include recallable loaned shares, eliminate minimum voting requirement for renomination, limit the circumstances under which the maximum number of candidates is reduced, extend the timeframe for candidates to provide information to the company, and limit board discretion in interpreting the bylaw.