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2016 Proxy Season Preview

By Shirley Westcott

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Overview

The 2016 proxy season is shaping up to be another milestone year for proxy access. The sheer volume of proposals—at close to 200—has well surpassed 2015 levels and continues to spark a tidal wave of corporate adoptions. In addition to the New York City Comptroller's Boardroom Accountability Project, now in its second year, individual investors have stepped up their proxy access filings while cutting back on some of their longstanding initiatives, such as independent board chairs and special meeting and written consent rights.

This year the proxy access debate has shifted beyond ownership thresholds to ancillary features in company bylaws that impact how usable access rights will be in practice. Efforts by retail investors to curb "problematic" provisions, such as group aggregation limits, quickly fell flat after the SEC concluded that adoption of a 3%/3-year proxy access bylaw, albeit with restrictions, constituted substantial implementation of their shareholder proposals. Nevertheless, secondary bylaw provisions will come into play when investors and proxy advisors evaluate corporate responses to last year's majority votes.

The heated presidential election is mobilizing shareholder campaigns on social issues ranging from income inequality to campaign finance and climate change. Climate-related proposals are on the upswing in the wake of the United Nations' Paris Agreement that commits nearly every country to reduce greenhouse gas (GHG) emissions. Activists are furthering their strategy by integrating climate risk into resolutions on compensation and political spending, and by challenging mutual funds whose public positions on combating climate change diverge from their proxy voting practices on the issue.

Money managers are also coming under fire this year for routinely backing outsized CEO pay packages. Other novel proposals in the compensation lineup touch on reducing gender pay gaps, linking CEO pay to executive diversity, and eliminating the impact of share repurchases from compensation performance metrics. But not all new initiatives will make it to ballots. Social activists' efforts at minimum wage reform and Qube Investment Management's revival of auditor rotation proposals have largely been omitted as ordinary business.

Finally, after reaching a record high in 2015, campaigns by activist hedge funds may recede this year, dampened by turbulent markets and portfolio losses. In keeping with recent trends, settlements with insurgents will likely continue to prevail over full-fledged proxy fights.

In short, this will be a challenging proxy season in a number of respects. Highlights of some of the key developments and shareholder proposals are discussed below.

Proxy Access

Building off last year's momentum, institutional and individual activists have ramped up their filings of proxy access proposals, which have reached nearly 200 to date. This compares to 121 resolutions submitted for all of 2015, of which 91 were voted on and 55 received majority support. Spearheading last year's campaign was the New York City Comptroller's Boardroom Accountability Project which accounted for 75 of the proxy access proposals and 43 of the majority votes. In all, 194 companies have implemented proxy access since the beginning of 2015, including many that did so proactively in the absence of a shareholder proposal.[1] The most popular formulation, adopted by over 70% of these firms, is 3/3/20/20—a 3% ownership level, three-

[1] To date, 210 companies have adopted proxy access rights, including 155 S&P 500 firms.

year holding period, 20-shareholder aggregation limit, and 20% board seat cap.

For 2016, the NYC Comptroller's Office has targeted 72 companies, primarily in the S&P 500 Index.[2] These are evenly divided between 36 new targets and 36 companies from its 2015 focus list that have not yet enacted or agreed to enact a 3%/3-year proxy access bylaw with viable terms—including companies where the shareholder proposal failed last year. Among the repeat targets are companies that implemented "unworkable" bylaws with a 5% ownership threshold, some of which have received binding bylaw proposals this year.[3] The new targets were selected from among the NYC Pension Funds' largest portfolio companies using the same criteria as last year—fossil fuel companies (particularly coal-intensive utilities), board diversity laggards, and companies with excessive CEO pay.

Individual investors, including access veterans James McRitchie and Myra Young and newcomers John Chevedden and Kenneth and William Steiner, are piling on over 100 additional proposals, in most cases with a more prescriptive 3%/3-year formulation that would explicitly allow an unrestricted number of shareholders to aggregate their shares and nominate the greater of two directors or 25% of the board. At Whole Foods Market, which adopted proxy access last summer, the proposal takes the form of a line-item veto of "troublesome" provisions in the company's bylaw, including the cap on group aggregations, the exclusion of recallable loaned shares, the prohibition on third-party compensation, and the requirement that shareholder nominees obtain a minimal level of support to be renominated.

Proxy Access: Omissions and Withdrawals

Notwithstanding the high volume of filings, many of this year's proxy access proposals will not reach ballots due to withdrawals and omissions.

The NYC Comptroller's Office reported in early January that it had already withdrawn 15 of its proposals at companies that adopted or agreed to adopt 3%/3-year bylaws, even though they imposed limits on group aggregations—typically 20 shareholders—and capped shareholder nominations at 20% rather than 25% of the board. Given the pace of adoptions—including by over two dozen more NYC targets since January—additional withdrawals can be expected in advance of companies' annual meetings.

Retail investors—particularly Chevedden and the Steiners—are less inclined to negotiate withdrawals.[4] As a result, over 20 companies that implemented 3%/3-year bylaws in response to gadfly filings have sought omission under the substantially implemented rule, based on the precedent established by General Electric in 2015. The SEC agreed with the issuers that their bylaws addressed the shareholder proposal's essential objective even though they contained additional restrictions, such as a 20-shareholder aggregation limit and/or a 20%-25% board seat cap with no two-director minimum. In response to this setback, McRitchie indicated that he and his affiliates will bring back their proposals next year when they cannot be mistaken as simply requesting proxy access rather than changing proxy access.

Concurrently, the SEC denied no-action relief under Rule 14a-8(i)(10) to three companies—Flowserve, NVR, and SBA Communications—that adopted proxy

[2] See the NYC Comptroller's 2016 focus list at http://comptroller.nyc.gov/wp-content/uploads/2016/01/2016-Proxy-Access-Focus-List.pdf.

[3] These include Cabot Oil & Gas, Noble Energy, and NVR. See the proposal at http://www.ceres.org/investor-network/resolutions/cabot-amend-proxy-access-bylaws-2016.

[4] McRitchie and Young withdrew their resolutions at Coca-Cola and Kimberly-Clark, which had sought no-action relief for substantial implementation. Chevedden, acting on behalf of Young, initially balked at the 3/3/20/2-or-20 framework proposed by Kimberly-Clark, preferring an aggregation limit of 50 shareholders and a nominee cap of two directors or 25% of the board. See http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/myrayoung012516-14a8.pdf.

access bylaws with 5% ownership thresholds. These and other firms with 5% access bylaws will likely face increasing pressure to reduce their ownership requirements, particularly following Vanguard Group's recent change to its proxy voting policy favoring a 3% rather than 5% ownership level for proxy access.[5]

Proxy Access: Early Votes and Proxy Advisor Recommendations

Early annual meetings are providing insight into how votes are shaping up, as well as how the proxy advisors are weighing in on this year's proxy access proposals and corporate responses to last year's majority votes (see Table 1).

A number of companies, including Costco Wholesale, Deere, Johnson Controls, and Starbucks, have opted to oppose the shareholder resolution rather than adopt access rights, largely because there is still a lack of consensus among their major investors on the issue and how it should be implemented. Indeed, a recent scorecard published by Fund Votes and the Nathan Cummings Foundation found wide divisions in mutual fund voting on last year's proxy access proposals.[6] Nevertheless, there will be relatively few corporate holdouts this year compared to 2015 when over half of the targeted companies rebuffed access resolutions.

So far, Institutional Shareholder Services (ISS) has supported shareholder resolutions at all of the non-adopters except CSP, which pushed back against McRitchie's requirement that shareholders be allowed to nominate the greater of two directors or 20% of the board. Because CSP only has a five-member board, a shareholder could effectively gain control of 40% of the board seats in one election. The resolution received a scant 7.5% support at CSP, but robust approval at Costco Wholesale (68.6%), Deere (60%), and Johnson Controls (70.6%).

ISS has also been backing the retail investor resolutions calling for more lenient terms than contained in previously adopted proxy access "lite" bylaws. This is consistent with its approach in 2015 where ISS favored 3/3/25 shareholder proposals that were silent on group aggregations over company bylaws or management resolutions with a 3/3/20/20 structure.[7] Investors, however, disagreed with ISS at Apple (32.4% support), AmerisourceBergen (31.6%), QUALCOMM (46.9%), Whole Foods Market (39.8%), and even Oshkosh (39.7% support), which has a 5% ownership threshold in its bylaw.[8]

In a January FAQ, ISS spelled out the acceptable parameters for responding to a majority-supported proxy access resolution.[9] This includes a proxy access framework that is no more restrictive than 3/3/20/20 and disclosure of outreach efforts where the board seat cap and aggregation limit differ from what was specified in the shareholder proposal. ISS will evaluate other restrictions in proxy access bylaws on a case-by-case basis, with the most problematic being post-meeting shareholding requirements and counting individual funds within a mutual fund family as separate shareholders.

To date, 41 out of 55 companies have responded to 2015 majority votes by adopting 3%/3-year access bylaws or by cleaning up previously enacted bylaws

[5] See Vanguard's 2016 voting guidelines at https://about.vanguard.com/vanguard-proxy-voting/voting-guidelines/index.html. Previously, Vanguard preferred a 3% proxy access threshold only in cases where the board was classified. According to a study by Fund Votes, Vanguard supported 18% of the proxy access proposals in 2015 under its old policy.

[6] See the Mutual Fund Proxy Access Voting Scorecard at http://ncf.org/sites/default/files/pa_scorecard_2015.pdf.

[7] See Expeditors International and Rite Aid. Unlike ISS, Glass Lewis was satisfied with the companies' 3/3/20/20 access formulations and opposed the shareholder resolutions in these cases. The proposal received 35% support at Expeditors International and 37.5% at Rite Aid.

[8] T. Rowe Price revised its voting guidelines for 2016 to clarify that it will vote against shareholder resolutions to amend existing proxy access bylaws that meet the general parameters of 3%/3 years with no significant impediments to group aggregations.

[9] See ISS's FAQ at http://www.issgovernance.com/file/policy/us-policies-and-procedures-faq-dec-2015.pdf.

with 5% ownership thresholds.[10] Monsanto went a step further and eliminated potentially problematic provisions ahead of its January annual meeting, such as being silent on the treatment of loaned shares, requiring a one-year post-meeting holding period, and prohibiting renominations for two annual meetings if the shareholder nominee is elected to the board or receives less than 25% support. These revisions apparently satisfied ISS and investors, who endorsed all of Monsanto's directors with over 99% support.[11]

Going forward, issuers should monitor key proxy access votes throughout the annual meeting season, as well as changes to institutional investor policies, no-action letters, and ISS's stance on responses to majority votes (see Table 2). This will aid first-time proposal recipients in evaluating their options and provide non-recipients with a framework for honing their off-season shareholder engagement.

Board Diversity

The slow progress on diversifying corporate boards continues to spur shareholder campaigns and potential regulatory action. Although women now hold 18.8% of board seats at Fortune 1000 companies—up from 17.7% in 2014—a recent study by the U.S. Government Accountability Office (GAO) estimated that even if women joined boards at the same rate as men, it would take 40 years for boards to achieve gender parity.[12] At the urging of Rep. Carolyn Maloney (D-NY), who commissioned the report, the SEC is exploring whether to require companies to disclose more information about the racial, ethnic, and gender composition of their boards. Under current rules, issuers must disclose whether diversity is considered in selecting director candidates, but they have discretion in how they define "diversity."

Shareholder pressure is also bringing about change. Although dozens of board diversity proposals have been filed in recent years, over 80% are typically withdrawn after companies agree to include diversity in their director selection criteria, according to ISS. This year, the North Carolina Retirement Systems is introducing a new proposal at Exelon and Ford Motor to expand their proxy disclosures on board diversity in line with recommendations made by nine public pension funds in a 2015 rulemaking petition.[13] This would include a description of the specific minimum qualifications the nominating committee believes must be met by a board nominee, as well a chart or matrix of each nominee's gender, race/ethnicity, skills, attributes, and experiences. The matrix approach, which has been endorsed by various investor and corporate groups, would make it easier for investors to evaluate overall board composition and whether the director nominees have the appropriate qualifications for the company's overall business strategy.[14] Based on its current disclosures, Ford was able to omit the proposal as substantially implemented.

Investor efforts to promote gender and racial diversity are extending beyond the boardroom to the executive ranks. Apple received a proposal from an individual investor to adopt an accelerated recruitment policy to increase the ethnic diversity of both senior management and the board, notwithstanding that Apple's leadership and overall workforce are 37% and 46% non-white, respectively. The resolution received 5.1% support. NorthStar Asset Management has also introduced a new proposal at IDEXX Laboratories, TJX, and WhiteWave

[10] Companies that dropped their ownership thresholds from 5% to 3% include CF Industries Holdings, HCP, Marathon Oil, and Priceline Group.

[11] See Monsanto's various amendments at http://www.sec.gov/Archives/edgar/data/1110783/000111078316000332/form8-k.htm.

[12] See the 2020 Women on Board's 2015 Gender Diversity Index at https://www.2020wob.com/sites/default/files/2020GDI-2015Report.pdf. See the GAO report at http://www.gao.gov/assets/680/674008.pdf.

[13] See the rulemaking petition at https://www.sec.gov/rules/petitions/2015/petn4-682.pdf.

[14] A number of companies—including Coca-Cola, Microsoft, Pfizer, and Prudential Financial—are already using a chart/matrix format in their proxy statements to present director skill sets, gender and/or ethnic diversity, and tenure.

Foods to use senior executive diversity as a performance measure for the CEO.

Director Tenure

Low director turnover is often cited as a contributing factor to the sluggish pace of board diversity. Among S&P 500 companies, mandatory retirement ages have been on the rise—34% of boards set it at 75 years or older—while the percentage of boards with an average tenure of 11 years or more has increased to 21%, according to the 2015 Spencer Stuart Board Index.[15] Only 3% of S&P 500 firms have term limits for non-executive directors.

Lengthy tenures have also raised concerns about director independence. To address this, several institutional investors are rethinking their voting policies on directors. In mid-March, the California Public Employees' Retirement System (CalPERS) will decide on revisions to its governance principles that would require companies to take a comply-or-explain approach towards long-serving directors. CalPERS maintains that director independence can be compromised after 12 years of service, at which point companies should either classify the director as non-independent or explain why they still consider him independent. Legal & General Investment Management Americas (LGIMA) also announced that beginning in 2017, it will vote against nominating committee chairs if average board tenure is 15 years or more, or if there haven't been any new director appointments in the past five years. LGIMA will additionally vote against lead directors or key committee members that have served for over 15 years.

A recent Harvard Law School study concluded that the rise in long-tenured directors ("new insiders") reflects a market attempt to recapture the traits and attributes that corporate insiders once brought to boards before regulations on independence forced them out.[16] Because independence is most vital on the audit and compensation committees, the author suggests term limits for their individual members.

Majority Voting and Director Removal

Two recent proxy battles are putting issuers on notice to revisit their majority voting and director removal provisions. In December, VAALCO Energy, which had declassified its board in 2009, faced a shareholder lawsuit in conjunction with a proxy fight because its charter only permitted director removal for cause. The Delaware Chancery Court invalidated the charter provision as conflicting with the Delaware General Corporation Law, which allows shareholders to remove directors with or without cause unless the board is classified or directors are elected by cumulative voting.[17] Although there are reportedly 175 similarly situated Delaware companies, Vice Chancellor J. Travis Laster attributed their combination of "wacky provisions" to people simply not reading the statute. Since the ruling, issuers have been scrambling to revise the director removal clauses in their charters and bylaws, many of which will appear on annual meeting ballots.[18]

Majority voting bylaws are also likely to draw increased investor and proxy advisor attention. In the recent proxy fight at Ethan Allen Interiors, ISS took issue with the potential entrenchment effect of the

[15] See the 2015 Spencer Stuart Board Index at https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/ssbi-2015_110215-web.pdf?la=en.

[16] See "The 'New Insiders': Rethinking Independent Directors' Tenure," by Yaron Nili at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2728413.

[17] See *In Re: VAALCO Energy, Inc. Consolidated Stockholder Litigation* at http://www.cadwalader.com/uploads/media/Vaalco_Energy_Ruling_NE122115bRulings.pdf.

[18] These include Aeropostale, Alamo Group, Alliance Data Systems, Cambrex, Charles River Laboratories, Cleveland BioLabs, Dr. Pepper Snapple Group, Equinix, Federal Signal, GameStop, Hologic, Jack Henry & Associates, JetBlue Airways, K12, Level 3 Communications, Mueller Industries, NorthWestern, People's United Financial, Quantum, salesforce.com, Sequenom, Toll Brothers, Valero Energy, Webster Financial, WPCS International, Williams-Sonoma, and World Wrestling Entertainment.

company's majority vote standard, which did not include a plurality carve-out for contested elections. Such a structure can give the incumbents an advantage over the dissidents because the incumbents would automatically remain in place—regardless of the level of support they receive—if the challengers fail to receive majority backing. According to ISS, 5.8% of Russell 3000 firms have a majority vote standard that applies to both contested and uncontested elections. Several companies, including Accenture and Murphy Oil, have already amended their articles and/or bylaws to apply plurality voting to contested elections.

Majority vote standards can also be ineffective in routine director elections if there is no requirement for a failed director to resign—which is the case in about 14% of Russell 3000 firms' majority voting bylaws, according to ISS.[19] Kenneth Steiner has submitted a proposal at Pfizer to adopt a policy mandating that a failed director be removed immediately from the board, unless a temporary holdover is critical to the functioning of the board. Although Pfizer has both majority voting and a director resignation policy, it could not exclude the resolution as substantially implemented.

Board Declassification and Supermajority Voting

This year, even traditional governance topics have some unique twists. John Chevedden and his retail investor affiliates are adding a new dimension to their proposals to eliminate supermajority voting provisions. Frustrated by having their resolutions preempted by "sham" management proposals that often fail, their requests now include a demand that targeted companies—Avista, FirstEnergy, OGE Energy, Southern, and Windstream Holdings—commit to spending up to $10,000 or more on proxy solicitation to obtain the "super-high vote" required for passage as a binding company proposal. Although the proponents consider this a critical element to their proposals, the SEC is allowing companies to omit them as substantially implemented if they are presenting a management resolution to repeal their supermajority voting requirements.

At least one board—Sonoco Products—is taking the bolder step of opposing its own declassification resolution, which it is submitting in response to a 2015 shareholder proposal. Although last year's vote tally indicated that the measure received majority support, the resolution was not properly presented. The proponent, William Steiner, did not attend the annual meeting, and his designee was not qualified under state law or Sonoco's bylaws to present the proposal on his behalf. It remains to be seen whether proxy advisors and investors will hold the company to their usual standards of board responsiveness—which include companies backing their own proposals—given these unusual circumstances.

The Chemours board is taking a circuitous approach to declassification by asking shareholders if they wish to *retain* the staggered board. The structure was put into place by E.I. du Pont de Nemours (DuPont) prior to the 2015 spin-off and before the current Chemours directors commenced service. Therefore, in line with the board's "against" recommendation, shareholders must *vote down* the proposal in order for the board to initiate declassification.

Initial Public Offerings and Dual-Class Stock

Proxy advisors and institutional investors are taking a tougher stance this year towards the governance regimes of newly public companies that insulate management from shareholders. ISS amended its 2016 voting policy whereby it may recommend against some or all directors of companies that listed with adverse governance provisions—particularly classified boards and supermajority vote requirements--unless they are put to a shareholder vote or sunsetted within three years. The Council of Institutional Investors (CII) has

[19] During 2015, six directors who failed their elections under a majority vote standard resigned from their boards. Four other failed directors (at Hospitality Properties Trust and Dex Media) remain on their boards because their resignations were not accepted, while a fifth (at Grand Canyon Education) will continue as a director until the 2016 annual meeting.

also adopted a statement of investor expectations for initial public offerings (IPOs) that advocates sunsetting problematic governance features.

Dual-class stock, which allows founders to retain control of their firms through superior voting rights, has become particularly troublesome for some investors—evidenced by the increasing support for shareholder proposals calling for the recapitalization of stock.[20] According to Dealogic, over 13.5% of companies that listed on U.S. exchanges in 2015 had dual-class structures, up from 12% in 2014 and 1% in 2005. In response to this trend, T. Rowe Price has amended its voting policies for 2016 to vote against the lead director or independent chairman, as well as all members of the governance committee, at companies that have dual-class stock with unequal voting rights.

Compensation

Several developments will be confronting issuers this year on the compensation front. The market downturn will undoubtedly stimulate greater scrutiny of pay-for-performance alignment as investors cast their votes on say-on-pay (SOP) proposals. Companies may also need to reexamine their director compensation programs in light of recent shareholder litigation at Facebook, Citrix Systems, and Goldman Sachs, and consider setting annual limits on director pay or carving out separate director plans for shareholder approval. Finally, pursuant to its fall 2015 regulatory agenda, the SEC expects to finalize rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act on pay-for-performance (PFP) and compensation clawbacks by October 2016. If completed on schedule, PFP disclosure would take effect in 2017, while the clawback proposal, which requires changes to stock exchange listing standards, would likely kick in the following year along with CEO pay ratio disclosures.

[20] Shareholder proposals advocating the elimination of dual-class stock averaged 29.6% in 2015 (where opposed by the board), up from 25.8% in 2014 and 26.6% in 2013.

Compensation-related shareholder proposals will remain modest in number, but proponents are shifting their priorities away from some longstanding topics, such as executive stock retention and clawback policies, to newer themes. Among the emerging issues, which are discussed below, are income inequality, government service golden parachutes, mutual fund voting practices, and the impact of stock buybacks on executive compensation.

Compensation: Pay Disparity

Income inequality remains a popular subject of shareholder resolutions, which have been reworked now that the SEC has finalized a long-awaited rule on the disclosure of CEO/worker pay ratios, which will take effect for fiscal years beginning on or after Jan. 1, 2017. Rather than asking for pay comparisons, this year proponents want retailers and fast-food chains to adopt minimum wage reform principles that would ensure a minimum standard of living for workers and their families and would be indexed to allow for orderly and predictable increases.[21] Broader requests—some of which have been omitted or withdrawn—ask companies to report on steps that can be taken to address economic inequality or to adopt compensation principles that are responsive to the U.S. economy, unemployment, working hours, and wage inequality.

Social activists have also filed various types of proposals at technology and financial services companies that deal with closing the gender pay gap. Several of the resolutions have been withdrawn, including at Intel which reported that it achieved 100% gender pay equity in 2015. Those that proceed to a vote are unlikely to fare better than last year where similar proposals registered only single-digit support.

[21] The two pay comparison proposals that have been submitted this year—at CVS Health and TJX—have been strengthened from 2015 to include an evaluation of whether senior executive compensation should be adjusted to take into account layoffs, the pay level of the lowest paid workers, or the 100x ratio in the Excessive Pay Shareholder Approval Act of 2009.

Efforts to address unequal pay practices are also reaching the regulatory level. In January, the Obama Administration announced an executive action requiring companies with over 100 employees to report salary data based on gender, race and ethnicity to the Equal Employment Opportunity Commission (EEOC). If approved, the rule would take effect in September 2017 and is expected to aid the EEOC and Department of Labor (DOL) in investigating discrimination complaints. On a separate front, Pax World Management has petitioned the SEC to require companies to annually report pay ratios by gender, or alternatively to provide guidance to companies on voluntary reporting.[22]

Compensation: Mutual Fund Voting Practices

Activists cite skyrocketing executive pay as a major driver of wider social inequality, enabled by money managers that "rubber-stamp" corporate pay packages. To hold investment firms accountable, As You Sow and the Stephen M. Silberstein Revocable Trust submitted resolutions at State Street and BlackRock to evaluate options for bringing their voting practices in line with their stated principles of linking executive compensation to performance.[23] The proponents note that between July 1, 2014 and June 30, 2015, State Street Global Advisors (SSGA) and BlackRock supported 97% and 99% of SOP proposals, respectively, at S&P 500 companies—significantly higher than the 90% average approval rating of other investment managers. The sponsors recommend that the funds adopt the best practices of other asset managers and rating agencies and utilize a broader range of research sources for interpreting compensation data. The proposal was withdrawn at State Street after it agreed to enhance disclosures pertaining to its framework for analyzing compensation programs, monitor compensation practices highlighted by As You Sow as areas of concern, and expand its screening process to review additional compensation packages.

Compensation: Stock Buybacks

The escalation of stock buybacks in recent years has drawn criticism from some investors that companies are maximizing short-term value and enriching executives at the expense of long-term investment and employment. To this end, the AFL-CIO Equity Index Fund, Amalgamated Bank LongView Funds, and Domini Social Investments have introduced a new proposal at six companies to exclude the impact of stock buybacks from the compensation formulas used for senior executives. Because executive pay packages are often linked to earnings per share and other financial indicators that get a boost from stock repurchases, executives may be rewarded for financial engineering rather than growth.[24]

Another proponent—Oregon State University professor Jonathan Kalodimos—is in favor of adjusting compensation metrics for stock buybacks, but otherwise advocates corporate payout policies that favor share repurchases over dividends. In his six proposals, he argues that dividends can be disadvantageous to investors because they trigger an automatic tax liability, and any cut in the dividend rate can spark a negative market reaction.

Compensation: Revolving Door Payments

The AFL-CIO has renewed its 2015 campaign against revolving door payments at Wall Street banks, whereby executives receive unvested equity awards if they resign to enter government service. In the proponent's view, such windfalls can undermine the independence

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[22] See Pax World's rulemaking petition at https://www.sec.gov/rules/petitions/2016/petn4-696.pdf.

[23] In a recent report, As You Sow cited 10 mutual funds that approved 95% or more of the pay packages of the 100 highest paid CEOs in 2015. See "The 100 Most Overpaid CEOs: Are Fund Managers Asleep at the Wheel?" at http://www.asyousow.org/ays_report/the-100-most-overpaid-ceos-are-fund-managers-asleep-at-the-wheel/.

[24] These concerns were echoed in a recent report by UNITE HERE examining stock buybacks at lodging REITs. See http://www.hotelcorpgov.org/wp-content/uploads/StockBuybacks2.pdf. In recent years, UNITE HERE has been targeting this sector with shareholder proposals on governance and takeover defenses.

of government officials who regulate Wall Street. This year's proposals, filed at six banks, want an outright ban on such payments. Last year's resolutions, which averaged 21.5% support, urged banks to disclose the eligible executives and dollar value of potential payouts.

Compensation: Link Executive Pay to Sustainability

Sustainability factors can have a material impact on a company's long-term prosperity, yet relatively few large-cap firms (24%) incorporate such measures into executive pay, according to Ceres.[25] To rectify this, social proponents are advancing more proposals on the topic this year, but are taking a less direct approach in order to bolster the historically low, single-digit support. Rather than ask companies to integrate sustainability into executive performance metrics, they urge them to simply assess the feasibility of doing so.

Environmental & Social

Environmental and social (E&S) issues will feature prominently among shareholder proposals this year, but 2016 submissions—at over 370 to date—are not expected to reach last year's record (475). As in past years, the bulk of resolutions address corporate practices related to climate change and lobbying/political spending, followed by human rights. In addition to several new initiatives within these categories (described below), social activists are introducing first-time environmental resolutions dealing with the reduction of food waste in landfills (received 28.1% at Whole Foods Market) and with the safe collection and disposal of consumer prescription drugs (AbbVie, Johnson & Johnson, and Merck).

E&S: Climate Change

Climate change pressure is intensifying this season following the Paris Climate Summit in December where 195 countries committed to limiting global warming to below two degrees Celsius. Almost 90 climate-specific proposals have been filed for 2016, primarily dealing with setting quantitative goals to reduce GHG emissions, increasing the sourcing and production of renewable energy, and reporting on the financial risks of stranded assets due to the regulation of carbon emissions and lower future demand for fossil fuels.

Although 43% of Fortune 500 companies have set targets for emissions reduction, energy efficiency, or renewable energy, according to the Greenhouse Gas Management Institute, some proponents want more aggressive action. The Sierra Club is trying to compel Ameren to move from coal-based technology to at least 30% wind and solar-sourced energy by 2030 and at least 70% by 2050. Meanwhile, Jantz Management filed several resolutions that call for an ambitious "net zero" carbon footprint by 2030, a commitment recently made by Germany's Siemens. The resolution faltered with 7.3% support at Deere, which opposed the measure as an unrealistic goal, and 7.1% support at Apple. Apple already powers 100% of its U.S. operations and 87% of its global operations with renewable energy, but the proponent wanted the carbon neutral target extended to the company's suppliers and manufacturers.

Energy companies continue to attract the most climate resolutions, including the more innovative ones. For a second year, oil and gas firms are being asked to decouple executive incentive pay from reserve metrics or to return capital to shareholders rather than develop fossil fuel reserves. Both measures generated only single-digit support in 2015. Also in a new twist, faith-based investors are appealing to Exxon Mobil to assert "moral leadership" on climate change by acknowledging the imperative to limit global temperature increases to less than two degrees Celsius. Exxon, which is facing eight climate-related proposals,

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[25] See Ceres' report at http://www.ceres.org/roadmap-assessment/progress-report/performance-by-expectation/governance-for-sustainability/executive-compensation-tied-to-esg-performance-1. Also see a recent Harvard University study, "Corporate Sustainability: First Evidence of Materiality," at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912.

is under investigation by the New York and California Attorneys General for allegedly misleading investors about the financial risks of climate change. This follows a two-year New York AG investigation of Peabody Energy which resulted in the company agreeing to disclose more details about the impact climate change regulations may have on its business. These actions, along with outside pressure from investors and Democratic lawmakers, could prompt the SEC to update its 2010 interpretative guidance on how companies should address climate change risks in their securities filings.

Activists look to proxy access as the next frontier for forcing issuers to address climate change by affording shareholders the ability to nominate climate experts to boards.[26] Since 2015, 50 institutional investors have been pressing 50 energy companies (the "50/50 Climate Project") to get serious about climate risk, including increasing the carbon competency on boards by building a bench of climate expert directors. According to 50/50 board member Richard Ferlauto, institutional shareholders that push proxy access proposals "view board accountability—rather than prescriptive precatory climate resolutions—as the preferred approach to corporate transformation."[27]

E&S: Lobbying and Political Contributions

Climate change is also underpinning many of the political activity proposals which, despite being an election year, are down in count from 2015. Among the filers is a coalition of 30 investors led by Walden Asset Management who are urging 11 oil and gas companies to disclose their lobbying activities and expenses and/or to review their public policy advocacy with respect to climate change. Environmental activists are particularly critical of corporate funding of trade associations such as the U.S. Chamber of Commerce and American Legislative Exchange Council (ALEC), which they contend are impeding regulatory efforts to mitigate climate change. Last August, Walden, in conjunction with 60 investors, wrote to 50 Chamber members to use their leverage to halt the organization's campaign against the Clean Power Plan (CPP). The U.S. Supreme Court has since blocked the Environmental Protection Agency from enforcing the CPP until legal challenges are resolved.

The conservative National Center for Public Policy Research (NCPPR) is pushing back with its own campaign finance resolutions challenging companies' funding of liberal causes, such as cap-and-trade legislation and the Affordable Care Act, or their decision to end ties to ALEC, which promotes limited government. Co-opting the same proposal format used by social activists, NCPPR asked CVS Health, Deere, Duke Energy, Johnson & Johnson, and Pfizer to analyze discrepancies between their political and electioneering contributions, including through trade association memberships, and their stated free-market principles. The resolution at Deere received 3.1% support, while the others were excluded because similar proposals sponsored by social proponents are either on 2016 ballots or did not obtain enough backing in past years to qualify for resubmission.

E&S: Proxy Voting Congruency

Despite the proliferation in climate change and political activity proposals in recent years, resistant companies and languishing shareholder support have prompted activists to rethink their strategies.[28] One avenue is to exert pressure on mutual funds that have poor voting records on endorsing these types of initiatives.

For a third year, Zevin Asset Management is taking Franklin Resources to task for incongruities between its

[26] Shareholder proposals calling on companies to add an independent director with environmental expertise to the board have historically averaged 20% support or less.

[27] See "Establishing a Climate Competent Board" at http://www.tacklingglobalwarming.com/docs/11_15_50-50.pdf.

[28] According to the Sustainable Investments Institute (Si2), average support for climate change proposals fell from 23.7% in 2014 to 21.9% in 2015. Average support for core political activity proposals (lobbying, political contributions, and public policy advocacy) was essentially stagnant between 2014 and 2015, with average support of 28.3% and 29%, respectively.

proxy voting practices and its stated commitments to preventing climate change. According to research conducted by Fund Votes, Franklin is near the bottom of the largest U.S. mutual funds in supporting climate change resolutions. T. Rowe Price and BlackRock, which have similar voting records, have received the same proposal. Unlike last year, however, the SEC did not grant exclusion of the proposal as ordinary business because the focus of the resolution has shifted to climate change, a significant policy issue.[29] The proposal received 4.5% support at Franklin Resources and was withdrawn at BlackRock because the proponent—James McRitchie—plans to revise and resubmit it in 2017.

Separately, the Corporate Reform Coalition—a group of investors and advocacy organizations—launched a campaign last fall urging Vanguard to change its proxy voting guidelines to support political spending disclosure proposals.[30] The initiative has reportedly generated 65,000 petitions to Vanguard, which last year opposed or abstained on every campaign finance resolution, according to a study by the Center for Political Accountability (CPA).[31] Vanguard responded that it has not been convinced that the prescriptive framing of E&S proposals addresses risks in a way that drives long-term value.

E&S: Human Rights

Shareholder proponents ranging from social and religious activists to labor unions and non-profits are tackling a variety of issues this year related to human rights. These include some new efforts dealing with fair labor practices, country selection guidelines, remedies for human rights violations, and employee training on human trafficking awareness and prevention.

A first-time proposal by the AFL-CIO urges companies to participate in a mediation process of any alleged human rights violations if requested by the Organization of Economic Cooperation and Development's (OECD) national contact point (NCP) in the U.S. (the Department of State). The NCP system is a grievance mechanism established by OECD governments in 2000 to resolve disputes between companies and victims of environmental, labor, and human rights violations. The proposal was submitted at PepsiCo and Mondelez International because they have refused to participate in NCP mediation and at Altria, Philip Morris, and Reynolds American where human rights violations in their supply chains are difficult to remedy.[32] Last year, the AFL-CIO and Province of St. Joseph of the Capuchin Order raised proposals at the three tobacco companies on the issue of forced labor and green tobacco sickness among migrant farm workers. The resolutions averaged 3.5% support.

Oxfam America has launched a new "Poultry Worker Justice Campaign" advocating safer working conditions and fair pay in poultry processing plants. The proposals generated 24.9% support at Sanderson Farms and 4.5% support at Tyson Foods, which announced last fall that it would increase the hourly wages of one third of its workforce. Pilgrim's Pride was able to omit the resolution as ordinary business.

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[29] Prior versions of the proposal asked the funds to review their proxy voting policies and practices, taking into account their corporate responsibility and environmental positions and the fiduciary and economic case for the shareholder resolutions presented. The 2016 proposal asks for a climate change report assessing any inconsistencies between the voting practices of the company and its subsidiaries and the company's policy positions on climate change.

[30] See the Vanguard petition at https://uspirg.webaction.org/p/dia/action3/common/public/index.sjs?action_KEY=13420.

[31] See the CPA study at http://files.politicalaccountability.net/CPA_-_mutual_fund_proxy_voting_-_2015_-_12-07-15.pdf.

[32] In 2014, the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco, and Allied Workers' Association (IUF) lodged complaints against Mondelez International and PepsiCo regarding renewal of a collective bargaining agreement and employees' right to form a union, respectively. Mondelez charged that the IUF was abusing the NCP process to coerce the company into a bilateral relationship with the union. See http://www.state.gov/documents/organization/226493.pdf and http://www.state.gov/documents/organization/227494.pdf.

Other human rights initiatives focus on specific regions of operation. The Holy Land Principles campaign, begun in 2012, is continuing into 2016 with eight resolutions calling on companies that do business in Israel/Palestine to sign an eight-point code of conduct of fair labor practices. At Cisco Systems, where support for the resolution in 2015 was below the 3% resubmission level, a new proposal asks for a breakdown of the company's workforce in Israel/Palestine using the nine job categories in the DOL's EEO-1 Report.

Another handful of firms, including Apple, Eli Lilly, Intel, General Electric, and Mohawk Industries are being asked to review their guidelines for doing business in the Israeli settlements (the Heartland Initiative) or in areas of the Middle East and Africa with abysmal human rights records (NCPPR). In the latter case, NCPPR is calling into question companies' stated commitments to suffrage, women's rights, and gay rights, while operating in countries where these rights are denied. The proposal at Apple received 1.8% support.

Hedge Fund Activism and Proxy Fights

Prolonged market volatility may dampen hedge fund activism this year, which was at a record high in 2015. According to FactSet SharkRepellent, 355 activist campaigns were announced against U.S. companies last year, of which 127 resulted in the dissidents obtaining at least one board seat or the right to appoint a new independent director, largely through settlements.

The trend towards settlements over protracted proxy battles is already being manifest in some of the biggest campaigns that were in the pipeline for 2016. Xerox and American International Group (AIG) capitulated to Carl Icahn early in the year, resulting in several board seats for the dissident and a breakup of Xerox. Yahoo! is also reportedly close to ceding two board seats to Starboard Value, though observers maintain that anything less than majority control is unlikely to appease the insurgent, especially after Starboard's successful full-board ouster at Darden Restaurants in 2014.

Veteran Yahoo! agitator Eric Jackson of SpringOwl Asset Management is needling the company as well, particularly over its lavish employee perks which he estimates "total half an Instagram." Jackson has also turned his sights on Viacom where he has called for an overhaul of the board and management and, more recently, a spin-off of Paramount into a tracking stock. His concerns over board independence, excessive CEO compensation, and poor returns are being echoed by Viacom shareholder Mario Gabelli, as well as proxy advisors ISS and Glass Lewis, which are urging investors to vote against the compensation committee members at the March 14 annual meeting.

REITs and retailers with extensive real estate assets will also be a prime sector for activists this year who are looking to monetize real estate holdings or for restructurings or sales of companies. After chalking up successes late last year with the sale of American Residential Properties and Associated Estates Realty, four-year-old Land & Buildings Investment Management reached a settlement with FelCor Lodging Trust and is gearing up for a board showdown at NorthStar Asset Management. Other firms in activists' crosshairs include Ashford Hospitality Prime, Ashford Hospitality Trust, Macy's, and Stratus Properties.

In addition to demands for divestitures, hedge funds continue to be catalysts for M&A activity, the most notable being the proposed mega-merger and subsequent three-way split of Dow Chemical and DuPont, which was induced by Trian Fund Management and Third Point. Still in the works is Canadian Pacific Railway's (CP) hostile pursuit of Norfolk Southern, backed by CP shareholder's second largest shareholder, Pershing Square Capital Management. Rather than nominate a board slate, CP is taking a softer approach by submitting a non-binding resolution asking the Norfolk Southern board to engage in good faith discussions on a merger. If voted down by Norfolk Southern shareholders, CP is prepared to walk away from its takeover bid.

Outlook

This promises to be another landmark year for proxy access adoptions, which have now reached 30% of S&P 500 companies. With almost half of this year's targets already acquiescing on the measure, issuers should expect shareholder campaigns on proxy access to intensify in the years ahead.

Although the remaining 2016 shareholder resolutions will draw far less attention and even fewer majority votes than proxy access, companies will need to be vigilant of other issues this season. These include continued alignment of compensation programs with financial performance in the event of a sustained market decline, as well as vulnerabilities to activist hedge funds. Boards should also begin making preparations for CEO pay ratio disclosure in 2018, as well as monitor the progress of outstanding Dodd-Frank rulemaking on compensation. Alliance Advisors will keep issuers apprised of these and other developments as the proxy season progresses.

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Table 1: 2016 Proxy Access Proposals - Initial Votes

Company	Proponent	2015 Vote[1]	Date Bylaw Adopted	Ownership %	# Holders	Ownership Years	# of Nominees	2016 Meeting Date	2016 Vote[1]	ISS Rec
AmerisourceBergen Corp.	Kenneth Steiner		18-Nov-15	3%	20	3	2 directors or 20%	3-Mar	31.6%	FOR
Apple Inc.	James McRitchie	39.2%	21-Dec-15	3%	20	3	20%	26-Feb	32.4%	FOR
Applied Materials, Inc.	Kenneth Steiner		8-Dec-15	3%	20	3	2 directors or 20%	10-Mar	30.4%	FOR
Barnwell Industries, Inc.	Ned L. Sherwood							7-Mar	34.4%	FOR
Costco Wholesale Corp.	James McRitchie, Myra Young							29-Jan	68.6%	FOR
CSP, Inc.	James McRitchie, Myra Young	49.0%						9-Feb	7.5%	AGAINST
Deere & Co.	John Chevedden							24-Feb	60.0%	FOR
Johnson Controls, Inc.	Unidentified							27-Jan	70.6%	FOR
Oshkosh Corp.	Unidentified		13-Nov-15	5%	20	3	20%	2-Feb	39.7%	FOR
QUALCOMM Inc.	James McRitchie		7-Dec-15	3%	20	3	20%	8-Mar	46.9%	FOR
Whole Foods Market, Inc.	James McRitchie		26-Jun-15	3%	20	3	20%	9-Mar	39.8%	FOR

Source: SEC filings, ISS.
1. Based on FOR votes as a percentage of FOR and AGAINST votes.

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Table 2: Responses to 2015 Majority Votes on Proxy Access

Company	Proponent	Date Bylaw Adopted	Ownership %	# Holders	Ownership Years	# of Nominees	2015 Vote[1]	2016 Meeting Date
AES Corporation[2]	NYC pension funds	25-Nov-15	3%	20	3	20%	66.4%	21-Apr
Alliance Data Systems Corporation	NYC pension funds	26-Jan-16	3%	20	3	2 directors or 20%	55.7%	June
Alpha Natural Resources, Inc.[3]	NYC pension funds						67.1%	May
American Electric Power Company, Inc.	NYC pension funds	20-Oct-15	3%	20	3	2 directors or 20%	67.2%	April
Anadarko Petroleum Corporation	NYC pension funds	15-Sep-15	3%	20	3	2 directors or 20%	59.4%	May
Anthem, Inc.	Harrington Investments	18-Feb-16	3%	20	3	2 directors or 20%	66.5%	May
Apache Corporation[4]	NYC pension funds	3-Feb-16	3%	20	3	25%	92.7%	May
Apartment Investment and Management Company	NYC pension funds	26-Jan-16	3%	20	3	2 directors or 20%	57.7%	26-Apr
AvalonBay Communities, Inc.	NYC pension funds	12-Nov-15	3%	20	3	2 directors or 20%	65.0%	May
Avon Products Inc.	NYC pension funds						75.7%	May
CBL & Associates Properties, Inc.	Connecticut, Kansas City Firefighters, City of Philadelphia PERS	11-Feb-16	3%	20	3	2 directors or 25%	69.0%	May
CF Industries Holdings, Inc.[5]	NYC pension funds	14-Oct-15	3%	20	3	25.0%	57.4%	May
Cheniere Energy, Inc.	NYC pension funds	13-Dec-15	3%	20	3	20%	63.1%	June
Chevron Corp.	NYC pension funds	30-Sep-15	3%	20	3	2 directors or 20%	55.3%	May
Cimarex Energy Corp.	NYC pension funds	11-Nov-15	3%	20	3	25%	56.2%	12-May
Cisco Systems, Inc.	James McRitchie						64.7%	November
Citigroup, Inc.[4]	John Chevedden for James McRitchie and Myra K. Young	22-Oct-15	3%	20	3	2 directors or 20%	86.9%	April
Cloud Peak Energy Inc.[6]	NYC pension	20-Oct-15	3%	20	3	20.0%	71.1%	11-May
ConocoPhillips	NYC pension funds	9-Oct-15	3%	20	3	2 directors or 25%	54.3%	May

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Company	Proponent	Date Bylaw Adopted	Ownership %	# Holders	Ownership Years	# of Nominees	2015 Vote[1]	2016 Meeting Date
Devon Energy Corp.	NYC pension funds	26-Jan-16	3%	20	3	2 directors or 20%	58.2%	June
DTE Energy Company	NYC pension funds	17-Sep-15	3%	20	3	2 directors or 20%	61.7%	5-May
Duke Energy Corp.	NYC pension funds	4-Jan-16	3%	20	3	2 directors or 20%	62.7%	May
eBay Inc.	NYC pension funds						59.4%	May
Electronic Arts Inc.	NYC pension funds						55.0%	August
EOG Resources, Inc.	NYC pension funds	22-Sep-15	3%	20	3	20%	50.7%	April
EQT Corporation	NYC pension funds	14-Oct-15	3%	20	3	2 directors or 20%	66.3%	20-Apr
Equity Residential	NYC pension funds	1-Oct-15	3%	20	3	20%	56.1%	June
FedEx Corp.	Marco Consulting Group						54.3%	September
Fidelity National Financial, Inc.	NYC pension funds	3-Feb-16	3%	25	3	2 directors or 20%	60.9%	June
FirstEnergy Corp.	NYC pension funds						71.4%	17-May
Freeport-McMoRan Inc.[7]	NYC pension funds						64.9%	June
Hain Celestial Group, Inc.[4]	James McRitchie						87.1%	November
Hasbro, Inc.	NYC pension funds	1-Oct-15	3%	20	3	2 directors or 20%	68.6%	May
HCP, Inc.[8]	NYC pension funds	28-Jan-16	3%	25	3	2 directors or 20%	55.5%	April
Hess Corp.	NYC pension funds	4-Nov-15	3%	20	3	2 directors or 20%	51.5%	May
Kohl's Corp.	CalPERS	11-Nov-15	3%	20	3	2 directors or 20%	73.3%	May
Marathon Oil Corporation[9]	NYC pension funds	26-Aug-15	3%	20	3	25%	62.7%	April
McDonald's Corp.	UAW	26-Oct-15	3%	20	3	2 directors or 20%	61.7%	May
Monsanto Co.[10]	Harrington Investments	11-Jan-16	3%	20	3	20%	53.5%	29-Jan
Murphy Oil Corporation	NYC pension funds	3-Feb-16	3%	20	3	2 directors or 20%	53.0%	May
Nabors Industries Ltd. (Bermuda)	NYC pension funds	3-Jun-14	5%	1	3	1 director	67.0%	June
Netflix, Inc.	NYC pension funds						71.0%	June
Occidental Petroleum Corp.	NYC pension funds	8-Oct-15	3%	20	3	2 directors or 20%	62.0%	May
Oracle Corp.	Nathan Cummings, UAW, Marco						55.0%	November

Company	Proponent	Date Bylaw Adopted	Ownership %	# Holders	Ownership Years	# of Nominees	2015 Vote[1]	2016 Meeting Date
	Consulting Group							
PPL Corporation	NYC pension funds	18-Dec-15	3%	25	3	2 directors or 20%	61.4%	May
Precision Castparts Corp.[11]	NYC pension funds						58.7%	August
Priceline Group Inc.[12]	NYC pension funds	23-Jul-15	3%	No Limit	3	25%	53.7%	June
Range Resources Corporation	NYC pension funds	29-Feb-16	3%	20	3	2 directors or 20%	60.9%	May
Republic Services, Inc.[4]	NYC pension funds						89.9%	May
Roper Technologies, Inc.	NYC pension funds						67.6%	May
Southwestern Energy Company	NYC pension funds	9-Nov-15	3%	20	3	2 directors or 20%	56.4%	May
St. Jude Medical, Inc.	UAW						72.5%	4-May
TCF Financial Corp.	Kansas City Firefighters	19-Oct-15	3%	20	3	25%	59.9%	April
Vertex Pharmaceuticals Inc.	NYC pension funds						58.4%	June
Visteon Corporation[2]	NYC pension funds						75.7%	June

Source: SEC filings.

1. Based on FOR votes as a percentage of FOR and AGAINST votes.
2. A non-binding management proposal failed in 2015.
3. Alpha Natural Resources filed for bankruptcy in August 2015.
4. The Apache, Citigroup, and Hain Celestial boards supported the 2015 shareholder resolution. The Republic Services board made no recommendation on it.
5. CF Industries Holdings amended its earlier bylaw, adopted Feb. 4, 2015, which had a 5% ownership threshold and capped shareholder nominations at 20% of the board.
6. A binding management resolution failed in 2015.
7. Freeport-McMoRan plans to adopt proxy access this year.
8. HCP amended its earlier bylaw, adopted on Feb. 8, 2015, which had a 5% ownership threshold, 10-person aggregation limit, and a board seat cap of 20%.
9. Marathon Oil amended its earlier bylaw, adopted on April 9, 2015, which had a 5% ownership threshold and a board seat cap of 20%.
10. Monsanto amended its earlier bylaw, adopted on June 5, 2015, to clean up potentially negative, ancillary provisions.
11. Precision Castparts is being acquired by Berkshire Hathaway.
12. Priceline Group amended its earlier bylaw, adopted on March 18, 2015, which had a 5% ownership threshold, a 20-person aggregation limit, and a board seat cap of 10%-20%.