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2015 Proxy Season Update

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This Georgeson Report gives an overview of the 2015 proxy season, with data as of July 15, 2015. Shareholder activism is not fully covered in this report, but will be addressed in Georgeson’s forthcoming Annual Corporate Governance Review.

Proxy access has been the biggest issue for the 2015 proxy season, and has been a significant turning point for the issue as a record-setting number of proxy access proposals gained widespread support. There were 106 proxy access proposals submitted this year, of which 16 were withdrawn or omitted. On average, proxy access has garnered 54 percent support, with 49 companies receiving a majority of votes cast voting in favor (vs. six in 2014).

In each of the prior three years, only 20 or fewer proxy access proposals had been submitted and many of these were sent to so-called “bad actors.” This year, the New York City Comptroller’s Office submitted 75 proxy access shareholder proposals, targeting companies based on three priority issues: climate change (33), board diversity (24) and excessive CEO pay (25).

An important component of the success of proxy access proposals is that Institutional Shareholder Services, Inc. (ISS) has supported every proxy access proposal. ISS’s policy is that it will generally support proxy access, provided that:

- There are no, or minimal, limits on the number of shareholders in the nominating group
- The nominating group holds three percent of the voting power for three years
- The proposal allows nominations of generally 25 percent of the board.

These three percent/three-year/25 percent standards are very similar to the 2010 SEC rule that was later voided, and the vast majority of proposals submitted follow this framework. All of the proxy access proposals in 2015 called for three percent ownership, and all but one for three years of ownership. Likewise, all but two proposals would allow nominations for 25 percent of the board.

Proxy access is no longer unusual, although it is far from being a practice as generally accepted as, for example, majority voting for directors. Even so, as proxy access becomes more common, it appears likely that it will rarely be used (consistent with its rare use in other countries where it is more commonly in place). It also seems unlikely to be used by shareholder activists who engage in traditional proxy fights. Rather, it will most likely be used as a carrot to encourage companies to engage their investors and to take action on issues of importance to their investors.

SEC RULE 14a(i)(9) “CONFLICTING PROPOSAL” EXCLUSIONS

Prior to the 2015 proxy season, in a surprising policy reversal, the Securities and Exchange Commission temporarily suspended its ability to provide informal staff “no-action” relief to exclude shareholder proposals from annual meeting proxy statements on the basis that they directly conflict with a management proposal involving the same subject matter. Because of the late reversal, many companies that were planning on submitting more company-friendly “conflicting” proxy access proposals – as a way to exclude the shareholder ones – were left in a quandary as to how to proceed. This became particularly challenging after many investors and proxy advisory firms warned that they would not support company directors if a company did not allow the shareholder proposal to go to a vote.
Some companies settled with the shareholder proponent and adopted a slightly different form of proxy access proposal that is more company-friendly than the shareholder version (these kept the key three percent/three-year provisions). Some variation was seen in the percentage of the board that the nominees could represent, with 20 percent as the most common alternate market standard. Likewise, the maximum number of investors that could comprise a nominee group has varied. While still in some flux as of writing this piece, a maximum group of 20 appeared to become the most common market standard, although some proposals or actual by-law adoptions called for fewer.

Most companies (84) decided to include the shareholder proposal, but expressed their opposition to it without including the company’s own proposal. However, seven companies included both the shareholder proposal as well as the company’s own proposal. Results from the seven proposals were mixed: three of the management proposals received a majority of votes cast and three of the shareholder proposals also received a majority of votes cast in favor of the proposal.

One company had neither the management nor the shareholder proposal receive majority support.

### Shareholder Proposal

<table>
<thead>
<tr>
<th>Company Name</th>
<th>For Percent Voted</th>
<th>Years Requested</th>
<th>Percent Requested</th>
<th>Nominations Up To</th>
</tr>
</thead>
<tbody>
<tr>
<td>AES Corporation</td>
<td>66.11%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Chipotle Mexican Grill, Inc.</td>
<td>49.48%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Cloud Peak Energy Inc.</td>
<td>70.82%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Exelon Corporation</td>
<td>43.16%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Expeditors International of Washington, Inc</td>
<td>34.42%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>SBA Communications Corporation</td>
<td>46.05%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Visteon Corporation</td>
<td>74.19%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

### Management Proposal

<table>
<thead>
<tr>
<th>Company Name</th>
<th>For Percentage Voted</th>
<th>Years Requested</th>
<th>Percent Requested</th>
<th>Nominations Up To</th>
</tr>
</thead>
<tbody>
<tr>
<td>AES Corporation</td>
<td>36.06%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>Chipotle Mexican Grill, Inc.</td>
<td>34.45%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>Cloud Peak Energy Inc.</td>
<td>25.88%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>10.00%</td>
</tr>
<tr>
<td>Exelon Corporation</td>
<td>52.06%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>Expeditors International of Washington, Inc</td>
<td>69.11%</td>
<td>3 Years</td>
<td>3.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>SBA Communications Corporation</td>
<td>51.57%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>Visteon Corporation</td>
<td>20.74%</td>
<td>3 Years</td>
<td>5.00%</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

In the two cases where management included the shareholder proposals and supported them, the proposal received overwhelming support (92.42 percent support at Apache Corporation and 86.78 percent support at Citigroup). In the one case (Republic Services) where the company did not take a position on the proposal but included it, the proposal garnered 89.05 percent support.

By contrast, a few companies agreed to strongly consider adopting/proposing proxy access by next year, with the appearance of having success in defeating the proposal on that basis.

At least one (Prudential Financial) pre-emptively adopted the proposal without any vote or proposal.
In addition, 68 exempt solicitations have been filed this season with regards to proxy access. The bulk of these were filed by the California Public Employees Retirement System (CalPERS) and the New York City Pension Funds in support of the proposals. Two companies reached formal agreements on interim vote tally releases. More agreements were likely done informally since formal agreements appeared challenging to negotiate this year.

WHAT’S NEXT FOR IMPACTED COMPANIES?

As with any other shareholder proposal, companies should be aware that if their shareholder proposals on proxy access passed, but they do not substantially implement them, they risk having ISS recommend AGAINST all of their directors in 2016. These companies, or those that are likely next targets, should therefore consider the following:

› Engaging with their shareholders to determine what proxy access parameters are appropriate and acceptable to their shareholder base. These companies may have as many as 60+ companies to refer to for examples of companies that have adopted, or have announced an agreement to adopt, proxy access.

› Having their proxy solicitor check the N-PX filings of their top shareholders to determine how their shareholder base voted on proxy access proposals this season, as many thought through the issue more deeply this year and changed how they voted in prior years. Notwithstanding such filings, some shareholders’ views on proxy access may continue to evolve over the fall and winter, which should be kept in mind when analyzing such data.

SAY ON PAY: SHAREHOLDER SUPPORT REMAINS HIGH

In its fifth year of mandatory votes, say-on-pay (SOP) proposals continued to receive high levels of shareholder support. The average support levels increased marginally from last year, and at slightly over 92 percent, this represents the best results for the proposal thus far. The results likely reflect the impact of ISS’s recommendations, as the percentage of ISS’s negative recommendations declined to its lowest level this year to 11 percent. The average vote in favor at companies that received ISS’s favorable recommendation remained at 95 percent level. However, in 2015 the level of support at companies that received ISS’s negative recommendation declined to a little over 64 percent.

As the median CEO total direct pay in 2015 grew by 8.2 percent (per ISS), the main reason for low levels of support on SOP proposal continues to be a pay-for-performance disconnect, where the CEO’s pay level is misaligned with the company’s stock price performance. Special one-time grants made to CEOs (and other named executive officers) without adequate justification and/or lacking performance conditions was also one of the main pay concerns for shareholders.

The 2015 proxy season saw executive compensation become an issue of increasing focus in proxy fight situations. Dissidents at Qualcomm Inc., DuPont Co. and Perry Ellis criticized the companies on the use of performance metrics that inappropriately rewarded executives for lack of true performance. At Shutterfly Inc., where the company’s SOP proposal has received low shareholder support in the past two years, the CEO’s pay became the dissident shareholder’s main complaint. In addition to supporting two of the dissident’s three nominees, shareholders rejected the company’s SOP proposal with over 78 percent opposition.

While average support levels for SOP proposals remain high, it is important for companies to pay attention to their specific situations. The companies should address any shareholder concerns from the previous year(s) or any misalignment that may have resulted from changes in compensation programs or as a result of poor performance.

TRENDS IN ENGAGEMENT

Independent directors are increasingly engaging with investors, driven primarily by the annual SOP votes. Certain institutional investors are calling for companies to proactively designate lead or other independent director(s) as available designee(s) for engagement with significant shareholders. Whether or not companies choose to create a formal structure, companies should ensure that such directors are well prepared, alert and not hostile to any such engagement, or else it may backfire on them. In addition, investors and the proxy advisory firms are very appreciative of companies that circulate in advance any agenda and/or slides that they plan to use for such engagement calls or meetings. When well executed, this engagement by independent directors generally helps both sides better understand each other and clarify any misunderstandings.

To broaden the reach of investor engagement, companies can use webcasts such as Glass Lewis’ “Proxy Talks.” Although rarely used, and then most often only for
controversial situations, these proxy talks provide an open forum for investors and company representatives to discuss specific issues. In addition, the discussions are monitored by Glass Lewis' research team in order to inform their analysis. Companies may also choose to utilize similar phone conferences hosted by Proxy Mosaic, known as "Mosaic Dialogues." Some companies, such as ExxonMobil, have organized their own webcasts. These options vary as to control over content and/or questions and participants. In addition, the proxy statement can include a personal message from your lead independent director (e.g., Prudential Financial) in the online interactive "tiles" version of the proxy statement. Companies can also introduce directors via videos hosted on company websites. See Microsoft's investor site for an example.

**INVESTOR LETTER-WRITING CAMPAIGN**

Several major institutional investors again wrote letters to companies (generally representing their largest holdings) supporting good corporate governance and reiterating how they may vote on certain issues.

Vanguard's letter encouraged company directors to engage with investors (in addition to addressing executive compensation, and board oversight and accountability). In addition to special "Shareholder Liaison Committees," this could also take the form of already established mechanisms for engagement with independent directors, e.g., part of an established role of the independent chairman or lead independent director. Vanguard also advised that it was best to include a description of a company's engagement process in its proxy materials and on the company website.

To date, we are aware that only one company, Tempur Sealy, has agreed to create a "shareholder liaison committee," following their proxy situation with H Partners.

BlackRock's letter to its largest investee companies encouraged them to take a long-term approach to creating value. This stance was framed as part of the corporate leaders' duty of care and loyalty to the company.

TIAA-CREF urged its top 100 investee companies to voluntarily adopt proxy access by October, using the three percent/three-year/25 percent model. More can likely be expected from them, as we proceed into the 2016 proxy season.

Other institutional investors that have engaged in prior letter-writing campaigns — prior to, or in connection with, submitting shareholder proposals — can be expected to add to this flurry of letter-writing in advance of the 2016 proxy season.

**OTHER HOT SHAREHOLDER PROPOSALS**

This proxy season brought the largest number of shareholder proposals submitted since 2010, driven largely by proxy access proposals. At the same time, other proposals have decreased in number, with more common practices being adopted by companies. A few notable statistics are listed below:

- **Require Independent Board Chairman** - 28.9 percent average of votes cast voting for, with two proposals passed this year after four in 2014. Average support for proposals that had ISS “for” recommendations was 15.4 percentage points higher vs. proposals with “against” recommendations in 2015. Investors are increasingly demanding a strong independent chair or independent lead or presiding director with duties that are clearly defined and robust. While lead directors are still in majority of board chairs, the percentage of independent chairs is still increasing across company sizes (per ISS).

- **Report on Lobbying Activity** - 22.7 percent average of votes cast voting for, with none passing this year or last. Average support for proposals that had ISS “for” recommendations was 17.7 percentage points higher vs. proposals with “against” recommendations in 2015.

- **Report on Political Activities and Contributions** - 25.2 percent average of votes cast voting for, with none passing this year or last. Average support for proposals that had ISS “for” recommendations was 23.5 percentage points higher vs. proposals with “against” recommendations in 2015.

- **Provide Right to Act by Written Consent** - 39.2 percent average of votes cast voting for, with two passing this year and none in 2014. Average support for proposals that had ISS “for” recommendations was 16.1 percentage points higher vs. proposals with “against” recommendations in 2015 (vs. 5.1 percentage points in 2014).
Provide Right to Call Special Meetings - 42.3 percent average of votes cast voting for, with four passing this year and last. Average support for proposals that had ISS “for” recommendations was 18.5 percentage points higher vs. proposals with “against” recommendations in 2015. Only one company in 2015 had ISS recommending against.

No accelerated vesting of equity upon Change in Control (CIC) - 33.8 percent average vote of votes cast voting for, with two passing this year and four in 2014, and ISS always supporting.

Report on Sustainability - 26.3 percent average of votes cast voting for, with none passing this year or in 2014.

Require Majority Voting in Director Elections - 63.2 percent of votes cast voting for, with eight passing this year and 16 in 2014, and ISS always supporting. These proposals are moving toward smaller companies with more voluntary adoptions after initial contact from the proponent, resulting in a higher average vote on half of the amount of proposals going to a vote. Majority voting is also now widespread and in place at 90 percent of S&P 500 companies and 55 percent of S&P 1500 (per ISS).

(Source: ISS Corporate Services, Inc.- Based on year-over-year comparisons of results for Russell 3000 from Jan. - July 15, with ISS difference based solely on the difference in average voting results between votes FOR and AGAINST ISS recommendations - with some 2015 votes still pending)

ISSUES OF INCREASING CONCERN TO INVESTORS

Director qualifications, tenure, independence and diversity

Director qualifications continue to come under scrutiny, continuing the trend from 2014 and accelerated by proxy access. They also relate to other issues such as board tenure, diversity, board evaluations and board succession planning, as well as engagement generally.

Abroad, under “comply or explain,” maximum board tenure is generally between 9-12 years. Academic studies’ conclusions about board tenure are mixed. While longer-tenured directors at some companies may be more secure in challenging management and perhaps in improving performance, this may cause governance problems at other companies, where so-called “stale” directors remain on boards past their useful tenure.

Concerning diversity, new female nominees jumped 81 percent at large-caps and more than doubled at the bottom half of the Russell 3000 between 2008 and 2014 (per ISS). Although not hitting the goal of 30 percent set by the Thirty Percent Coalition and similar groups, women represented 16 percent of all S&P 1500 board seats and at least 81 percent of studied companies had at least one woman director (vs. 69 percent in 2006). The Thirty Percent Coalition sent letters in 2015 to 100 companies with no women on their boards, further spurring on their mission. At the same time, ethnic minority directors are increasing by smaller percentages, with bigger gains at larger companies.

With respect to the related issues, some companies are beginning to include proxy statement charts and/or disclosure on board tenure and diversity, as well as on their related policies for board evaluations and CEO- and board-succession planning.

Environmental & social issues - calls for enhanced disclosure, monitoring and management of related risks

There were 64 environmental proposals that went to a vote in 2015. Companies in most industries are enhancing their disclosure, with larger companies as the main leaders of voluntary sustainability and climate change disclosure, but with the greatest increase from the smaller companies (per The Conference Board, or TCB). The TCB also reports that companies are taking these issues more seriously as a “critical element of a company’s growth strategy”:

“[CEO] priorities revolve around meeting market demand for socially and environmentally conscious products and ensuring sustainability is part of corporate brand identity and culture.”

“[Companies need] societal license to operate, which relies on building trust by acknowledging both the risks and opportunities related to their company’s environmental and social impacts.”

“For S&P Global 100 companies that break out revenue for sustainable products or services separately, that revenue stream grew at six times the rate of overall company results.”
On the social issues front, the 2015 CPA-Zicklin Index on political activities and lobbying is expanding its benchmarking from the top 300 to all of the S&P 500 companies, with the same 24 indicators as in 2013 and 2014. Data collection began in June, and the Center for Political Accountability (CPA at www.politicalaccountability.net) sent preliminary scores based only on publicly available information to companies for review on a rolling basis starting in late June, with the release of their Index findings scheduled for early October. The CPA again partnered with the Sustainable Investment Institute, a non-profit that conducts impartial research on companies ESG practices, to collect the data.

**Cybersecurity Issues from a Proxy Statement and Shareholder Engagement Perspective**

This proxy season also brought additional disclosure about cybersecurity, as investors are looking more closely at director qualifications to see:

- Who may know the questions to ask of management (particularly chief information security officers, or CISOs) and outside experts
- Who should be serving on the relevant board committee that takes a deeper dive

Discussions and disclosure should be tailored for company-specific industries, with more detail for the more vulnerable ones.

Boards should be familiar with how their companies match up with the risk management framework of the National Institute of Standards and Technology (or NIST), as this may begin to appear in shareholder proposals and more ISS recommendations. However, such NIST analysis is really only the beginning. Generally speaking, if your board is not yet challenged by the amount that they are hearing about cybersecurity risks and management, they are probably not doing enough in this area.