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Creating Opportunity in a Period of Volatility

Trouble for the World's Reserve Currency

An Overview of Hedge Funds

CORPORATE Finance REVIEW

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PROXY SEASON 2013 — ANNUAL ELECTIONS IN THE CORPORATE SECTOR OFTEN INFLUENCED BY TRENDS IN POLITICS AND THE AMERICAN CULTURE

The United States of America in the second decade of the 21st century seems to be a country with a population deeply divided by strongly held beliefs and ideologies. Witness the cultural, political, and social divide — often along the fault lines of the familiar contrast in liberal–conservative beliefs regarding public finance, Republican–Democrat difference in public policymaking, the rich–poor/income-inequality debate, arguments over policy between northern and southern states and cultures, and more.

While these differences are often played out in the media and in real world politics, there are ways in which the publicly held corporation boards and managements can become ensnared as activist shareowners request information or action related to "S" (social) or "E" (environmental) issues. One example in "S" is the rapid and dramatic change in public opinion on same-sex marriage, with recent public referenda showing widening acceptance and support for lesbian or gay marriages (and voluntary adoption in some states for sanctioning such unions). This, in turn, affects the ways in which companies are changing benefit programs, some changes to comply with law and others to adjust to cultural shifts or employee demands.

The proxy season as culture cockpit

Very often the cockpit for thrashing out the differences in the ways that societal issues are perceived plays out in the corporate proxy ballot during "proxy season," when shareholders of publicly owned enterprises cast their ballots to elect members of the board. In the voting they approve or deny resolutions placed on the ballet. The resolutions set forth for consideration are usually developed by management and board; these might address electoral issues (majority voting, board declassification, separation of chair and CEO, proxy access, and other governance issues).

Under certain circumstances an individual or institutional shareholder may present a resolution he or she sponsored for consideration by the entire shareholder body. (Typically, this has to meet criteria such as the number of minimum shares owned and specific period of time of ownership.) If the company challenges the resolution and the Securities & Exchange Commission (SEC) does not issue a "no action" letter, the language will be included in the proxy materials and distributed to all shareholders. ("No action" signals that the SEC staff advises no action be taken if the resolution is omitted from the proxy.)

In recent years we could say that the SEC did issue rules on some "social" issues — consider the "say-on-pay" advisory vote by shareholders to address the scheduling of shareholder voting on executive compensation. (The first question put before the shareholder body was to decide the frequency of an advisory nonbinding vote on the executive compensation packages of the senior corporate officers.) This was one of the provisions of the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act.

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In recent years there has been heightened debate in the general culture about the "wealth divide," (and the real or perceived inequities in salaries, as demonstrated by the often-cited expanding ratio of CEO to average employee salaries) and during proxy season the issue is addressed by activist shareowners.

"E" and "S" proposals gaining shareholder support

As reported by the nonprofit Investor Responsibility Research Center (IRRC), the characteristics of environmental and social ("E" and "S") shareholder proposals show that such proposals are gaining in increased voting support from investors. From 2005 to 2011, support more than doubled, from 10 percent to 20 percent of votes cast. In the same period, the proportion of shareholder-sponsored resolutions on the ballot grew by one-third, from about 30 percent to 40 percent of all proposals moving to a vote. The IRRC researchers observed that prominent "E" and "S" proposals tend to be associated with, and supported by, socially responsible investors (SRI) and public employee pension funds. Proposals connected with current events gain their prominence from association with headline-creating events — often in the regulatory, legislative, and global arenas. (One example of "global arena": growing consumer and shareowners interest in corporate supply chain activities.)[1]

THE THEMES OF THESE SHAREHOLDER-SPONSORED RESOLUTIONS HAVE EXPANDED FROM THE MEASURES THAT USUALLY ADDRESSED JUST GOVERNANCE ISSUES IN THE 1980s AND EARLY 1990s TO INCLUDE AN EVER-WIDENING RANGE OF SOCIAL ISSUES AND ENVIRONMENTAL MANAGEMENT CONCERNS.

A comprehensive body of information has built up over the past two decades regarding the results of shareholder-sponsored resolutions and voting on the issues raised — including data on proposals receiving votes (volume and proportion of total vote), proposals omitted, proposals withdrawn by the sponsor, and the nature of the resolution (the theme, if you will).

Looking at the trends, the themes of these shareholder-sponsored "E" and "S" (as well as "G") resolutions have expanded from the measures that usually addressed just governance issues in the 1980s and early 1990s to include an ever-widening range of "societal" or social issues and environmental management concerns. In this space we've explored previous proxy seasons and the issues in focus.[2] The trend lines for issues closely track with concerns in the general population about issues that in some way involve the corporation or that the activist shareholder believes the corporation could influence (its own policies, practices, and behaviors).

The 2013 proxy arena — Climate change and political spending

After the recent headlines about "two billion dollars" being spent by political parties, individuals, political action committees (PACs), and new fundraising and allocating mechanisms in the 2012 election cycle, there is heightened awareness of the role that corporate dollars play in American politics. And so, in 2013 a number of shareholder-sponsored resolutions on corporate proxies are scheduled for vote in the peak "season," (the first half of calendar year 2013).

Setting the tone for this year's proxy voting season on corporate involvement in political affairs, more than 60 institutions joined in filing and co-filing a uniform resolution at more than 50 public companies seeking "comprehensive disclosure of corporate lobbying," including both direct and indirect lobbying activities. "Whether the issue is environmental impact, consumer protection, financial reform, or shareholder rights, it is important for investors to understand how company dollars are spent to influence our law and regulations by lobbying activities," said Timothy Smith, one of the coordinators of the initiative and director of ESG shareowner engagement at Walden Asset Management.[3]

The model resolution urges companies to disclose more about their corporate "political" spending, which generally can affect elections and legislation, so that shareowners can evaluate whether a company's lobbying advances the company's interest and does not pose risk to company value. As an example of the resolution language, the filers request:

- company policy and procedures governing lobbying (direct and

indirect) and grassroots lobbying communications;
- payments use for (a) direct or indirect lobbying or (b) grassroots lobbying communications; the amount of the payment and recipient;
- membership in and payments to any tax-exempt organization that writes and endorses model legislation; and
- description of the decision-making process and oversight by management and board for making payments.

Indirect lobbying refers to the lobbying by a trade association; grassroots lobbying communication refers to communication directed to the public that refers to specific legislation or regulations. The investors request that the board audit committee oversees the report and that results be posted on the corporate website.

These resolutions come forth against the background of the very expensive political campaigns of recent years; "anti-consumer" lobbying by the U.S. Chamber of Commerce (for or against certain proposed legislation), or opposition to proposed regulation or rules; and the revelations of public support for, and participation in, the activities of the American Legislative Exchange Council (ALEC). ALEC develops "model" legislation that is then promoted at the state level.[4]

IN THE 2012 ELECTION CYCLE, $1.322 BILLION IN CONTRIBUTIONS TO ALL PRESIDENTIAL CANDIDATES WAS REPORTED BY THE FEDERAL ELECTION COMMISSION (FEC).

In the 2012 election cycle, $1.322 billion in contributions to all presidential candidates was reported by the Federal Election Commission (FEC). President Barack Obama raised $722 million; Governor Mitt Romney, $447 million. The Democratic Party raised $722 million; the Republican Party, $596 million. These sums include individual and PAC, political party, joint fundraising committee, and candidate funds.[5]

The U.S. Supreme Court ruling on *Citizens United vs. Federal Election Commission* (U.S. 310 (2010)) held that the First Amendment prohibited the government from restricting independent political expenditures by corporations or labor unions. The court found that portions of the McCain–Feingold Act (technically, the Bipartisan Campaign Reform Act, BCRA) of 2002 violated the First Amendment.[6]

With the passage of BCRA, and then after the Supreme Court's decision, there was a rise in the number of "527" groups, which are tax-exempt organizations (under the Internal Revenue Service Section 527) created to influence election results in federal or state office. These are often referred to as "Super PACs" because of the large sums of money that can be raised somewhat anonymously. And so, activist shareowners would like to know more about corporate contributions made to influence laws or candidacies.

The SEC, in considering proposal of a rule to mandate disclosure of corporate political spending in 2011 and 2012 (in response to a request by a group of leading law professors), drew more than 300,000 public comments in support.

Climate change and the corporation

Another important focus for activist shareowners are the issues related to climate change. In 2013, there will be at least 365 social and environmental shareholder proposals filed, according to the nonprofit Sustainable Investments Institute.[7] Many of these call for expanded disclosure by companies on their views of the risks and opportunities inherent in climate change.

For example, at Chevron Corporation, filer Christopher Reynolds Foundation is seeking a report on the physical risk exposure, cost estimates, and plans to mitigate climate risk. At Motorola Solutions, New York City Office of Comptroller is requesting that the company have its suppliers issue sustainability reports to report on human rights, supply chain, sustainability, and worker safety.

At ExxonMobil, filers Christopher Reynolds Foundation and the Province of St. Joseph, Capuchin Order are requesting a similar climate risk report. The company is being asked to review the exposure and vulnerability of facilities and operations to catastrophic weather events and to climate risk generally. The

board is asked to issue a report to shareowners that reviews the company's disaster risk management and describes the plans to reduce exposure and vulnerability. ExxonMobil does address climate change in its 10-k filing. Says Steve Viederman, finance chair of the Reynolds Foundation: "These disclosure statements are vague narratives, providing no actual data or plan, and provide little actual transparency. Our position is trust, but verify." Similar climate change disclosure resolutions were filed in 2012, including at Chevron; these were not necessarily the top proxy issues for the larger body of shareholders.

PRESIDENT BARACK OBAMA SIGNED AN EXECUTIVE ORDER IN JULY 2009 REQUIRING FEDERAL AGENCIES TO "LEAD BY EXAMPLE" IN SETTING SUSTAINABILITY GOALS AND REPORTING ON PROGRESS.

Possibly bolstering the activist shareowners' position on climate change over the coming proxy seasons is the recent action of the influential Government Accountability Office (GAO), a nonpartisan investigative arm of the U.S. Congress. GAO has maintained a "High Risk List" of issues since 1990 to guide public policymaking. Climate change was added in February 2013, with this comment by the GAO:

> Climate change poses significant financial risks to the federal government, which owns extensive infrastructure...insures property...and provide[s] emergency aid in response to natural disasters...the federal government is not well positioned (today) to address the fiscal exposure presented by climate change and needs a government-wide strategic approach with strong leadership to manage related risks...[8]

What is important to note here is that President Barack Obama signed an executive order in July 2009 — EO 13514, "Federal Leadership in Environmental, Energy and Economic Performance" — requiring federal agencies to "lead by example" in setting sustainability goals and reporting on progress. Major (corporate) government suppliers are expected to follow suit.[9]

2012 proxy voting season results

Looking back at the 2012 U.S. proxy season, author Ted Allen (writing in the National Investor Relations Institute member publication *IR Update*) identified "say-on-pay" and proxy access measures as those that commanded the most attention of the investor relations and finance professional. Some 72 percent of firms received more than 90 percent shareowner approval (of the plan) according to a survey of 1,907 companies' voting experience. Most of the companies also received majority votes in the first year of voting (2011) under the Dodd–Frank rules. Companies engaging the shareowner base and improving pay-related disclosure usually enjoyed a larger favorable vote on "say-on-pay" in 2012 (compared to 2011).

Among the issues in focus in 2012 (we can expect these issues to continue to be raised by shareowners) is "proxy access." While a federal court prevented the SEC from moving ahead in 2011 with the SEC's proposed rule (14a-11), the issue did not die there. There were 20 motions on company-specific ballot access in 2012. As Ted Allen explains, the successful proposals called for a 3 percent ownership position for three years with a cap of 25 percent on board seats available to access candidates. These (nonbinding) proposals received majority support at Chesapeake Energy and Nabors Industries, according to Allen.[10]

The role of investor coalitions

Institutional and some individual investors band together for concerted action in developing support for shareowner-sponsored resolutions. An example is the Interfaith Center on Corporate Responsibility (ICCR), a coalition of 300 institutions; most are activist investors. Members include religious orders, denominations, SRI funds, foundations, and trusts.

The group notes that:

> ...ICCR is the pioneer coalition of active shareholders who view the management of their investments as a catalyst for change. Member organizations with $100 billion in AUM have an enduring record of corporate engagement that has demonstrated influence on policies promoting justice and sustainability in the world....

ICCR members file resolutions and invite other institutions to join in support. In 2013, ICCR members have filed 180 resolutions at 127 companies, addressing such issues as human rights, supply chain accountability, corporate

financial practices, access to health care, food and water sustainability and environmental health, and a variety of measures addressing corporate governance. One-third of the resolutions (52) were focused on corporate lobbying and political spending. Part of the focus of ICCR members is on the "conflict between corporate advocacy through trade association membership and lobbying, and the corporate public positions on policies (such as healthcare, financial reform and environmental reform)."[11]

ICCR member institutions have called for "tougher" greenhouse gas emission (GHG) reduction goals and more investment in renewable energy sources. Companies in focus are in such industries as retailing, extractive (mining and exploration), financial services, food retailing, the "energy intensive" IT sector, and utilities. A group of 34 investor groups have filed a resolution calling for ExxonMobil to reduce its GHG emissions. Employing social media, ICCR has a Twitter campaign (#ProxyVoteForPlanet) that invites shareholders to report when they vote their proxy in favor of climate change.

U.S. investors and genocide in far-off lands

A shareholder proposal at the large mutual fund advisory firm Franklin Templeton Investments requested that the board institute transparent procedures to ensure that the fund managers do not invest in (or recommend investment in) companies that "substantially contribute to genocide or crimes against humanity." The sponsor is "Investor Against Genocide," which is a project of the Massachusetts Coalition to Save Darfur, Inc. A similar resolution submitted at TIAA-CREF was withdrawn when T-C adopted a public policy against investments linked to genocide. The large fund complex then divested holdings in PetroChina. A similar resolution at JPMorgan Chase gained the support of large public employee retirement systems, including the systems of California, New York state, Florida, Ohio, Connecticut, New York City, and labor unions.[12]

Summing up

Shareowners are increasingly focusing on corporate strategies, actions, policies, and practices that in various ways affect or could influence political, social, cultural, and other opinions and public policies. Activist shareowners turn to the proxy ballot box to express their concerns and set forth their expectations; increasingly, shareowner-sponsored resolutions on corporate political involvement, climate change, and other "E" and "S" issues are gaining the support of other investors. The public corporation has become a cockpit of action on these issues at annual voting time. ■

NOTES

[1] IRRC Institute, Key Characteristics of Prominent Shareholder-sponsored Proposals on Environmental and Social Topics, 2005–2011, (Washington, D.C., 2013). The research covered 1,300 shareholder-sponsored resolutions on "E" and "S" issues, voted across the Russell 3000 companies. Available at: www.irrcinstitute.org

[2] See: Corporate proxies: The "traditional" season has become a year-round process for investors (March/April 2012); Corporate proxy seasons: Proxies for the debate about whose interests are served — "Owners" or managers and boards "in control" (Nov/Dec 2010); Key issues to watch in proxy season 2008 (March/April 2008); and other commentaries in *Corporate Finance Review*.

[3] Smith, T. (Walden Asset Management), Institutional investors continue to press companies for disclosure of lobbying (news release), Boston, MA, (Feb 1 2013).

[4] American Legislative Exchange Council — Work-in-progress model legislation includes Class Actions Improvement Act, revisions to basic class action statute or rule; Electricity Freedom Act, addressing requests that electric distribution utilities provide a percentage of power from renewable sources; and other draft laws deemed "business-friendly" by critics. See: http://www.alec.org/meetings/spring-task-force-summit-2013/

[5] Federal Election Commission, 2012 Presidential Campaign Finance, Washington, D.C. Available at: http://www.fec.gov/disclosurep/pnational.doc

[6] U.S. Supreme Court, Oct 2009 Term. Available at: http://www.supremecourt.gov/opinions/09pdf/08-205.pdf

[7] Sustainable Investments Institute, Washington, D.C. See: siinstute.org

[8] "GAO adds financial risks of climate change to high risk list." Government Accountability Office, Washington, D.C., (Feb 14 2013).

[9] "Federal Leadership in Environmental, Energy and Economic Performance," Executive Order 13514, President Barack Obama, (Oct 5 2009).

[10] Allen, T., A look back at the 2012 U.S. Proxy Season, *IR Update*. (Alexandria, VA: National Investor Relations Institute, Sept 2012).

[11] *2013 Proxy Resolutions and Voting Guide* (New York, NY: Interfaith Center on Corporate Responsibility) (announcement of Feb 1, 2013 on proxy season activities).

[12] "Franklin Resources Shareholders to Vote on Genocide-Free Investing Proposal" Investors Against Genocide, Boston, MA (announcement of Jan 24, 2013). Available at: http://investorsagainstgenocide.net/