



Council of Institutional Investors
The Voice of Corporate Governance

November 2014

CII INVESTOR-COMPANY ROUNDTABLE

The Shareholder Proposal Process

For well over a half century, the proxy rules have provided shareholders with an essential tool for expressing their views to management, directors and other shareholders on major policy decisions and other matters that are important to them. The shareholder proposal is particularly useful to long-term investors like Council of Institutional Investors' members who—due to their sizable ownership stake of portfolio companies and their commitment to passive investment strategies—are unable to exercise the “Wall Street walk” and simply sell their shares when they are dissatisfied. Filing a resolution is one tool some of these long-term owners use to present concerns, encourage reform and hope to improve board and company performance. These proposals give the marketplace at large the opportunity to weigh in on an issue and communicate views to directors, management, regulators and legislators.

Particularly in recent years, strong support for certain non-binding shareholder proposals has prompted profound reforms to the U.S. corporate governance model. Board practices that today are considered integral parts of modern corporate governance—such as majority-independent boards, the annual election of each director, and a majority vote requirement for his or her election—would not perhaps exist without a robust shareholder proposal process bringing the issue to the forefront.

While this mechanism for reform continues to serve a vital purpose, frustration continues over the burdens and complexity associated with the process. In light of these concerns, CII convened on July 9, 2014 a roundtable of CII members with extensive experience in the shareholder proposal process.

Moderated by Keir Gumbs of Covington & Burling, the roundtable offered representatives of large companies and institutional investors the opportunity to share their concerns, identify common ground and discuss avenues for improving the efficiency and effectiveness of the shareholder proposal process. Subject to Chatham House rules, the discussion yielded frank observations about the practices that currently characterize the process as well as additional practices that could improve it.

The two constituencies reached general agreement in certain areas. However, views diverged on how to address underlying specifics. Not all views expressed in this paper reflect the opinions of all roundtable participants. The purpose of this paper is to circulate salient points of view as a foundation for enhancing the process for all concerned.

Communication

Company representatives and shareholder proposal proponents agreed that shareholder proposals are an important form of communication. They also agreed that both sides should take care throughout the shareholder proposal process to (1) ensure accuracy in any correspondence—whether by letters, dialogue or shareholder proposals; (2) be responsive; and (3) treat the other side with respect.

Proponent views:

- Shareholder proposals are an invitation to dialogue and should not be considered a hostile act.
- Communicating with companies before submitting a proposal can be beneficial. However, in some circumstances proponents may not consider pre-proposal communications practical or warranted due to a variety of factors, including:
 - a proponent's internal processes may preclude pre-filing communications;
 - a company's past practices or lack of responsiveness may be interpreted as a signal that pre-filing communications would be ineffective;

- timing considerations—for example, unanticipated negative company news revealed near the filing deadline—may render pre-filing communications impractical or impossible.
- When responding to shareholders, companies should address the particular issue in question and the particular concerns raised by the proponent. Communications should focus on the substance of the particular issue and any relevant context and should not involve “dog and pony show” rhetoric about the company and its regard for shareholders.
- Proponents interpret the company’s selection of representatives for engagement and written communications as a signal of how seriously the company regards both the shareholder and the issue.
- Decision makers on the board—such as the chair of the board committee most relevant to the proposal, the independent chair or the lead director—should lead a company’s response and/or dialogue. It is the company’s prerogative whether to include management in engagement discussions and in some cases management’s presence enhances the quality of the engagement. Outside consultants, such as compensation consultants or investor relations staff may also be included, but they should not be the lead representative or spokesperson in an engagement.

Company views:

- Proponents are strongly encouraged to contact companies before filing a proposal. Communications—via letters, email, phone calls or meetings—with companies before the filing of a proposal give the board and management more time to understand and evaluate issues, to engage with shareholders and to negotiate mutually satisfactory settlements without the time and expense of the proposal process.
- Carefully-crafted, tailored correspondence and proposals gain credibility with the board by establishing that proponents have done their homework and understand how an issue pertains to a company’s unique facts and circumstances. Letters or proposals containing factual errors or only boilerplate language run the risk of not being taken seriously by directors and management.
- Shareholders should have the ability to retain third-parties to assist with the drafting of correspondence or proposals or dialoguing with companies. However, they should also have a reasonable grasp of the issue, be capable of competently presenting the issue, be responsive to company outreach and participate in dialogue. Shareholders who fully outsource the shareholder proposal and company engagement process to agents may lower their credibility with directors and management.
- Companies face a limited time frame to respond to shareholder proposals and in some cases have significant internal procedures for reviewing submissions and determining a response. The more advance notice of an issue of concern to shareholders, the better.
- The board should oversee the proposal process while not necessarily leading it.

Clarity

Company representatives and shareholder proposal proponents agreed that clear information—regarding issues, goals, processes, and preferred participants in discussions—from both sides enhances communications.

Proponent views:

- When contacted by a shareholder, companies should provide details about their processes and timelines—including involvement of the board of directors—for responding to correspondence and/or shareholder proposals.

Company views:

- Proponents should be clear with companies about their end goals, the author of the proposal and the people with whom the proponent wishes to speak. Early communication of this information enhances the opportunity for substantive company-investor engagement.

No-action requests

Company representatives and shareholder proposal proponents agreed that directors should play a role in decisions regarding the pursuit of no-action relief from the U.S. Securities and Exchange Commission.

Proponent views:

- No-action arguments based on trivial factual errors and minor technicalities, such as challenging the stock ownership of institutional investors experienced with shareholder proposals, are a waste of time and resources both for companies and proponents and detract from a meaningful engagement process.
- Company resources spent on no-action requests may be better spent engaging with proponents on the substance of the proposal or simply allowing shareholders to vote on it. If there are questions about the accuracy of a statement, it is preferable to give the proponent an opportunity to amend the proposal before going to the SEC.

Company views:

- The filing of a no-action request is not a hostile act. Timing considerations may necessitate the submission of a no-action request before any engagement has commenced. However, no-action requests should not be interpreted as signaling a company's unwillingness to dialogue.
- Proponents have an obligation to comply with the shareholder proposal rules, and companies have the right to challenge proposals if they believe there are legitimate grounds for exclusion.
- Although shareholder proposals are not typically binding, the importance of the no-action process has increased for companies with the prospect of directors receiving high "against" or "withhold" votes if they decline to implement actions requested in majority-vote-winning resolutions.

Roundtable Participants

Amy Carriello, PepsiCo
Mike Garland, NYC Funds
Jessica Lau, PepsiCo
Aeisha Mastagni, CalSTRS
Meredith Miller, UAW RMBT
Mike McCauley, Florida SBA
Jennifer O'Dell, LIUNA
Susan Permut, EMC
Brandon Rees, AFL-CIO
Linda Scott, JPMorgan Chase
Dannette Smith, UnitedHealth Group
Carin Zelenko, Teamsters

Facilitator

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Observers

Glenn Davis, CII
Con Hitchcock, Hitchcock Law Firm
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