

Top 10 Key Trends at 2020 Proxy Mid-Season

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It is impossible to discuss this proxy season without acknowledging the impact that the COVID-19 pandemic has had and its resulting highs and lows.

While the virus has upended the planning and conduct of annual shareholder meetings, it has also caused regulators, issuers, third-party vendors and other market participants to collaborate to avoid significant disruption this season. The SEC has nimbly stepped into the fray with guidance and relief for issuers. State governments have issued emergency orders or amended legislation to allow for virtual shareholder meetings. Investors and proxy advisory firms have issued more flexible policies, all of which taken together has allowed meetings in the United States to proceed. Here are the key trends we are seeing mid-season:

1. Shift to Virtual Meetings

U.S. public companies are expected, as a result of the pandemic, to hold a record number of 1,500 virtual meetings this year as compared to only about 300 in 2019. Some investors and proxy advisors have traditionally expressed skepticism as to whether virtual meetings can provide the level of shareholder participation that physical meetings can, but this season has shown, based on reports from certain large-cap companies, that shareholder participation has in fact increased. Indeed, certain prolific shareholder proponents were able to “attend” more meetings this season with travel no longer a factor. Market participants were able to carry out the first ever contested virtual meeting. That’s good news. This virtual meeting “mass experiment,” however, has made more pronounced flaws in proxy plumbing. For companies that used multiple vendors to support their virtual meetings, vendors were asked to provide workarounds to compensate for clunky technology or privacy concerns, some of which were granted and some not, due to no fault of the providers or the companies, but to the limits of the system. We expect issuers to continue to host virtual meetings in 2021 and thereafter. When the dust settles this season, both issuers and investors will put forth best practices to try to address lingering concerns.

2. Increased Support for Certain Governance and E&S Proposals

For the first time in recent seasons, the governance proposals submitted were about equal in number to environmental, social and political (E&S) proposals. We’ve witnessed an unprecedented two independent chair proposals pass as well as increased (though not majority) support for various other independent chair proposals, with certain proxy advisory firms and investors updating and strengthening their applicable voting policies this season. Companies involved in scandals or non-governance litigation were more likely to see support for these proposals. We’ve also seen the novel use of independent chair proposals as a vehicle for an underlying E&S agenda, much like the use of majority voting proposals to further E&S goals last season. Given these successes and the difficulty in negotiating exclusions, we expect independent chair proposals to be popular next season, with possible links to COVID-19-focused agendas such as income inequality and pay practices, or workforce or human capital treatment and management.

On the E&S side, proponents have filed more than 400 shareholder resolutions so far this season with the most popular topics being climate change, political spending and gender diversity. Seven of twenty-three proposals voted on, have passed as of May 10, 2020, as compared to three of nineteen for the corresponding time period last year.

E&S proposals receiving majority support covered human capital management disclosures, political contributions, employment diversity reporting, climate lobbying reporting, petrochemical- and climate-related risk disclosures, and opioid risk reporting. Issuers can be sure that proponents will assess their wins and losses this season to devise their future strategies. Based on this, the upcoming presidential election in November 2020 and any concerns about COVID-19-related political contributions and lobbying, we expect more political contributions and lobbying proposals seeking transparency to be filed for next season.

3. Resurgence of Poison Pills

At least forty companies have adopted poison pills this year as an antitakeover defense due to the sudden stock price declines caused by the pandemic. We view the significant increase in the number of pills adopted (which contrasts to the twenty-five in existence at the end of 2019) as reasonable. The majority of proxy advisory firms have issued guidance showing some leniency for pills adopted without shareholder pre-approval so long as the pill duration is less than one year and the adoption is linked to the virus. Rights plans that have a 10% or higher trigger and carve-outs for passive investors, as well as a commitment by the company to put the pill up for vote at the next annual shareholder meeting if the pill is still in place at that time, tend to be viewed more favorably. We expect more rights plans, particularly net operating loss, or NOL, plans to be adopted this year similar to those adopted post-2008 financial crisis.

4. Stock Buybacks and Dividends

Buybacks and dividends have come under enhanced scrutiny post-pandemic as evidenced by the CARES Act restrictions on businesses receiving loans and loan guarantees. Generally speaking, however, the larger passive institutional investors defer to companies on their capital allocation decisions if the rationale is reasonable, communicated and disclosed. While certain market participants strongly believe that buybacks or dividends should not be conducted at the expense of workforce pay and training, buybacks and dividends are arguably supporting retail investors who rely on dividends as a source of income.

5. Executive Compensation Changes

We've seen some companies cut their executive or director compensation (mainly in the salary, and not long-term, component) to increase liquidity or demonstrate shared sacrifice with rank-and-file employees. By the end of the season there will be more data on whether and how companies have made adjustments to their short- or long-term incentive plans, such as revaluing or resetting triggers, which companies generally have tried to hold off on to avoid windfalls depending on the stock price. Of course, none of these decisions are impacting the current Say on Pay votes as those are based on 2019 compensation, but will be relevant for next season's vote.

6. Focus on Both Board and C-Suite Diversity

Board diversity remains a hot topic with investors and proxy advisory firms, with one firm committing to issue for the first time voting recommendations against directors seeking reelection to corporate boards with zero women. In response to a New York City Comptroller letter campaign, various companies agreed this season to implement a "Rooney Rule" policy with respect to director and, notably, CEO searches. The National Football League, from which the Rooney Rule originates, just expanded its namesake rule in late May to apply to lower-level management ranks. Issuers should remain vigilant for a matching ask in the future.

7. Director Overboarding an Increasing Investor Concern

Several institutional investors have tightened their overboarding policies with some now counting an independent chair role as two board seats. Mid-season, overall director support hovers in the mid-nineties percentile range. It is unclear whether this tightening will have a material impact on director support. Companies would be well served postseason to review their director overboarding policies and views of key investors, especially in light of the pandemic, which is making demands on director bandwidth arguably more acute than ever.

8. Sustainability Focus on Temporary Pause?

Before the pandemic truly hit the U.S., companies were focusing on the public calls by certain large institutional investors for more sustainability disclosure in line with certain existing voluntary disclosure frameworks or else risk against or withholds votes for their directors. Observing the extraordinary circumstances posed by the pandemic, these large institutional investors have since recognized that companies need to address near-term issues such as liquidity and resiliency, business continuity and operational challenges, including workforce health and safety and supply chain disruptions; however, they have also made it clear that they will continue to monitor company disclosures and expect a return to companies focusing on material sustainability items in due course.

9. Adoption of Exclusive Federal Forum Provisions

The Delaware Supreme Court found in late March 2020 that forum-selection charter provisions requiring that 1933 Act claims be brought in federal court are facially valid. For private companies considering IPOs, the potential advantages of adopting an exclusive federal forum provision can be significant. Whether an existing public company should adopt an exclusive federal forum provision in its bylaws or charter is more complex, requiring consideration of a number of factors, such as the anticipated number of offerings under registration statements, risk of shareholder scrutiny and proxy advisors' reactions. A handful of small- and mid-cap tech or life sciences public companies with annual meetings in the latter half of the proxy season have included federal forum provision charter amendments as ballot items in their proxy statements, citing indirectly to the Delaware case as rationale. How those companies fare as well as how related litigation plays out will be of interest to those companies considering adopting this provision.

10. Status of SEC Proposed Rulemaking

Two of the most closely watched proposed rule amendments in the corporate governance sphere were issued by the SEC in November 2019. One would amend the shareholder proposal process and the other would regulate proxy advisory firms. Both have elicited strong support or opposition from market participants, including issuers, retail shareholders, institutional investors, activist hedge funds, academics and the advisors themselves. Some investors continued to comment on the shareholder proposal rule proposal well into May 2020. Neither proposed rule amendment has been finalized despite the encroaching Congressional Review Act "deadline." Thus, if a new administration is elected this year, and these rules are finalized in the latter part of 2020, the new administration could undo these changes, much like the current administration rolled back regulations in 2017.