"Proxy Season Post-Mortem: The Latest Compensation Disclosures"

Tuesday, June 18, 2024

Course Materials

“Proxy Season Post-Mortem: The Latest Compensation Disclosures”

Tuesday, June 18, 2024

2 to 3:30 p.m. Eastern [archive and transcript to follow]

Our annual webcast focusing on the “lessons learned” that companies can start carrying forward into next proxy season. It’s time to analyze what was disclosed and what was not in the 2024 proxy season! Join these experts:

- **Mark Borges,** Principal, Compensia, and Editor, CompensationStandards.com
- **Dave Lynn,** Partner, Goodwin, and Senior Editor, TheCorporateCounsel.net and CompensationStandards.com
- **Ron Mueller,** Partner, Gibson Dunn & Crutcher LLP

Among other topics, this program will cover:

- The State of Say-on-Pay During the 2024 Proxy Season
- Highlights and Tips From This Year’s CD&As
- Best Practices for Disclosing Incentive Compensation Adjustments and Outcomes
- Trends in Disclosure Regarding Operational and Strategic Metrics
- Pay Versus Performance: SEC Staff Guidance Issues and Year 2 Enhancements
- Compensation Clawback Policies — Multiple Policies/Potential Disclosure Issues
- Perquisites Disclosure and Recent Enforcement Focus
- Shareholder Proposals — Company Strategies, No-Action Trends, Activists and Universal Proxies
- Proxy Advisory Firms — Is Their Influence Starting to Wane?
- Rule 10b5-1 Plan Disclosure Developments
- Pending SEC Rulemaking

“Proxy Season Post-Mortem: The Latest Compensation Disclosures”

Course Outline/Notes

1. The State of Say-on-Pay During the 2024 Proxy Season

    - Disclosures and outcomes for Say-on-Pay votes in 2024 (as required by Rule 14a-21 and Item 24 of Schedule 14A) — current average and failure rates

    - 2024 pain points for Say-on-Pay

    - Reminder for responsiveness expected by proxy advisor policies when Say-on-Pay support is “low” (70% for ISS and 80% for Glass Lewis)

2. Highlights and Tips From This Year’s CD&As

    - Discussion of disclosures under Item 402(b) of Regulation S-K in 2024

3. Best Practices for Disclosing Incentive Compensation Adjustments and Outcomes

    - Non-GAAP considerations

    - Managing volatility

    - Adjustment policies

    - Considering special discretionary adjustments

    - ISS’s updated FAQs for equity plans and compensation policies

        - *Disclosure of adjustments to metric results, including non-GAAP adjustments (Question 41):* Non-GAAP metrics are commonly utilized in incentive pay programs, and the performance results (and consequently the payouts) can be significantly changed by adjustments approved by the board. If such adjustments materially increase incentive payouts, companies should provide clear disclosure in the proxy explaining the nature of the adjustment, its impact (dollar or percentage) on payouts and the board's rationale. Disclosure in the proxy of line-item reconciliation to GAAP results, when possible, is considered a best practice. The absence of these disclosures would be viewed negatively, as would adjustments that appear to insulate executives from performance failures — particularly for companies that exhibit a quantitative pay-for-performance misalignment.

4. Trends in Disclosure Regarding Operational and Strategic Metrics

- Trends in key operational and strategic metrics — environmental/climate, cyber, DEI

- DEI metrics and disclosures after the Supreme Court's decision in *Students for Fair Admissions v. Harvard*

- CD&A disclosure requirements for operational and strategic metrics under Regulation S-K Item 402(b)

5. Pay Versus Performance: SEC Staff Guidance and Year 2 Enhancements

- Review of second-year proxy season disclosures under Item 402(v) of Regulation S-K adopted by the SEC in August 2022

- Guidance available for Year 2 through CDIs (*see* Regulation S-K CDIs, Questions 128D.01 – 128D.30 and Interpretive Responses 228D.01 – 228D.02)

- Consideration of SEC comment letters

- The expected 2024 approach by SEC Disclosure Staff

    - More likely the Staff may ask companies for more analysis and correction rather than simply a commitment to correct issues next year

- The Staff's early 2024 reminders:

- Remember to include the required "relationship" disclosure as a separate element of your disclosure. It's not sufficient to simply say there's no relationship.

- If you're using a non-GAAP "company-selected measure," be sure to disclose how that measure is calculated from the GAAP financials.

- In the table itself, make sure you're using the exact headings that the rule dictates. If you're providing supplemental disclosures, take a look at the adopting release for how to approach that.

6. Compensation Clawback Policies — Multiple Policies/Potential Disclosure Issues

    - What 2024 proxy statement disclosure under Regulation S-K Item 402(b) for new clawback policies adopted pursuant to stock exchange listing standards (Section 303A.14 of the NYSE Listed Company Manual and Nasdaq Rule 5608, required by the Dodd-Frank Act and Rule 10D-1) tells us about how companies approached required versus voluntary policies.

    - Proxy statement disclosure if a restatement occurs (Regulation S-K Item 402(w))

7. Perquisites Disclosure and Recent Enforcement Focus

    - Recent perks enforcement actions show this is still a focus area of the SEC's Enforcement Division and highlight the importance of:

        - Complete director and officer ("D&O") questionnaires

        - Thorough company process to determine whether flights should be disclosed as perks

        - Employee training

        - Company policies

    - Recent media attention on personal use of corporate aircraft

8. Shareholder Proposals — Company Strategies, No-Action Trends, Activists and Universal Proxies

- 2024 trends in shareholder proposal topics and support levels versus 2023

- Reactions to the Rule 14a-8 no-action process in 2024

- Using the new online form

- Tips from the Staff:

    - Proxy Print Dates: On the web form, the anticipated print date field should be the drop-dead date by which you need to hear back to get your proxy printed on time. The Staff realizes that the printer needs a few days, but it's annoying to work toward a deadline and see the proxy statement still hasn't been filed yet a few weeks later.

    - Email, Don't Call: The Staff requests that you email, rather than call, them with status updates, print date reminders or if your print date has moved. Calls take up a lot of Staff time.

    - Email Delivery Issues: The Staff doesn't want to be involved in email delivery issues. Companies and proponents should be acknowledging receipt of emails when requested and should be able to work out email issues without involving the Staff.

9. Proxy Advisory Firms — Is Their Influence Starting to Wane?

- Recent research ("Custom Proxy Voting Advice" by Edwin Hu, of NYU School of Law; Nadya Malenko, of Boston College; and Jonathon Zytnick, of Georgetown University Law Center) found that most institutional investors that engage one of the major proxy advisors don't use their benchmark recommendations, but instead receive recommendations from ISS or Glass Lewis based on a tailored set of preferences and even depart from those recommendations from time to time, which seems to show that the proxy advisors permit those shareholders to focus their own attention on the most contentious votes

10. Rule 10b5-1 Plan Disclosure Developments

- Use of 10b5-1 plans since the SEC adopted amendments to Rule 10b5-1 in December 2022 (and subsequent CDIs)
- New disclosure requirements under Item 408 of Regulation S-K regarding insider trading policies and D&O 10b5-1 plans
- Disclosures regarding the company's use of 10b5-1 plans not required since paragraph (d) of Item 408 was vacated as part of the legal challenges to the share repurchase disclosure amendments

11. Pending SEC Rulemaking

- Section 956 of Dodd-Frank: Financial Institution Incentive Compensation (final rulemaking stage)
- Rule 14a-8 Amendments (final rulemaking stage)
- Human capital management disclosures (proposed rulemaking stage)
- Corporate board diversity (proposed rulemaking stage)

“Proxy Season Post-Mortem: The Latest Compensation Disclosures”

Table of Contents — Course Materials

10 Tips for Preparing Your 2024 "Pay Versus Performance" Disclosure

With the 2024 proxy season just around the corner, it's time to begin preparing the executive compensation information that will need to be included in the proxy statement for your 2024 annual meeting of shareholders, including the second round of "pay-versus-performance" disclosure. As we learned in 2023, the "pay-versus-performance" disclosure required by the SEC's executive compensation disclosure rules can be both challenging and, at times, tedious; with the disclosures of many technology and life sciences companies averaging four pages of often highly-detailed information. The good news is that for purposes of this next disclosure cycle, most companies will be able to leverage the knowledge gained from their initial filings in drafting their disclosure. In addition, we also have the benefit of the comments issued by the SEC Staff from their review of the initial batch of "pay-versus-performance" disclosures, as well as the Staff's interpretive guidance (comprising 30+ Compliance and Disclosure Interpretations) at our disposal.

To assist you with this year's disclosure, we highlight several items that we have learned over the past several months that should help make your 2024 compliance efforts go more smoothly. If this is your first time complying with the "pay-versus-performance" disclosure rule, or if you would like to refamiliarize yourself with the rule's requirements, please see our Thoughtful Pay Alert, SEC Adopts New Rules for "Pay Versus Performance" Disclosure Requirement (Sept. 9, 2022), as well as our Thoughtful Disclosure Alert, "Pay Versus Performance" Disclosures in the Technology and Life Sciences Sectors (Oct. 24, 2023).

10 Tips for Preparing Your 2024 "Pay-Versus-Performance" Disclosure

➢ Companies May Limit Reconciliation Tables to the Most Recently Completed Fiscal Year for "Pay-Versus-Performance" Tables Following Their Initial Table

➢ Companies May Omit Confidential Information When Disclosing Material Changes in Assumptions in Calculating "Compensation Actually Paid"

➢ Use of Custom Peer Group in Subsequent "Pay-Versus-Performance" Tables Requires Calculating Peer Group TSR for all Fiscal Years Presented Using the Most Recent Fiscal Year Peer Group

➢ Date When Performance-Based Vesting Condition is Considered Satisfied Depends on Specific Facts and Circumstances

➢ Absent Limited Exceptions, Changing the Composition of Custom Peer Group in Subsequent "Pay-Versus-Performance" Table Requires Comparison of Company TSR to Both New and Former Peer Groups

➢ Companies May Specifically Designate Only One Financial Performance Measure as the "Company-Selected Measure"

➢ Disclosure of Named Executive Officers Must Include All Individuals Who Were Named Executive Officers at Any Time During Covered Fiscal Year

➢ Broad Equity Market Index May Not be Used to Calculate Peer Group Cumulative TSR

➢ Smaller Reporting Companies That Lost This Status as of January 1, 2024 May Continue to Use Scaled Disclosure in 2024 Proxy Statements if Filed Within 120 Days of 2023 Fiscal Year End

➢ Emerging Growth Companies That Lost Status as of January 1, 2024 Should Probably Use Published Industry or Line-of-Business Index to Report Peer Group Cumulative TSR

10 Tips for Preparing Your 2024 "Pay Versus Performance" Disclosure (Continued)

1. Companies May Limit Reconciliation Tables to the Most Recently Completed Fiscal Year for "Pay-Versus-Performance" Tables Following Their Initial Table

When calculating "compensation actually paid" ("CAP") for your principal executive officer and, on average, for your other named executive officers ("NEOs"), SEC rules require companies to disclose in footnotes to the "Pay-Versus-Performance" Table each of the amounts deducted and added pursuant to the rules to arrive at the appropriate CAP amounts for each covered fiscal year. Since these footnotes may be quite voluminous where a company is providing CAP amounts following its initial "Pay-Versus-Performance" Table, the SEC Staff has indicated that it is permissible to limit such information to the most recent fiscal year unless the information for prior fiscal years is material to an investor's understanding of the information reported for the most recent fiscal year or the required relationship disclosure comparing CAP and the various financial performance measures included in the table *(see Compliance and Disclosure Interpretation Question 128D.03)*. However, in its initial "Pay-Versus-Performance" Table, a company must provide footnote disclosure for each of the periods presented in the table.

2. Companies May Omit Confidential Information When Disclosing Material Changes in Assumptions in Calculating "Compensation Actually Paid"

SEC rules provide that, for purposes of calculating CAP, if in determining an equity award's "fair value" any assumption made in the valuation differs materially from that disclosed as of the grant date of such equity award, a company must disclose the assumption in a footnote to the "Pay-Versus-Performance" Table. While this requirement is likely to arise most often when recalculating the "fair value" of stock options (or performance share awards containing a market condition), it may also come up in the context of performance share awards containing a performance condition. In fact, the SEC rules specifically provide that "for any awards that are subject to performance conditions, calculate the change in fair value as of the end of the covered fiscal year based upon the probable outcome of such conditions as of the last day of the fiscal year."

If satisfying this disclosure would involve confidential information (as may be the case where the probable outcome has changed from one fiscal year to the next), the disclosure of which would result in competitive harm to the company, it may omit the information if it would be eligible for this confidentiality protection. Where this situation arises, however, the company must be as transparent as possible without disclosing the confidential information, such as giving a range of outcomes or discussing how the performance condition impacted the "fair value" determination. In addition, the company should discuss how the undisclosed change in the probable outcome assumption affects how difficult it will be for its executives to earn the underlying award or how likely it will be for the company to attain the performance condition *(see Compliance and Disclosure Interpretation Question 128D.22)*.

3. Use of Custom Peer Group in Subsequent "Pay-Versus-Performance" Tables Requires Calculating Peer Group TSR for All Fiscal Years Presented Using the Most Recent Fiscal Year Peer Group

SEC rules require companies (other than smaller reporting companies ("SRCs")) to disclose their peer group cumulative TSR, with the "peer group" being either the published industry or line-of-business index used for purposes of the stock performance graph included in either its "glossy" annual report or its annual report on Form 10-K or, if applicable, the companies it uses as a peer group for purposes of its Compensation Discussion and Analysis ("CD&A"). Where a company is using the CD&A peer group (rather than the performance graph peer group) to report peer group cumulative TSR, it must use the peer group that it is disclosing in its current proxy statement as the peer group for each of the fiscal years covered in the "Pay-Versus-Performance" Table. In other words, in the case of a company with a calendar fiscal year-end, the cumulative peer group TSR disclosed in the table for fiscal 2020, 2021, 2022, and 2023 is to be calculated based on the company's 2023 peer group *(see Compliance and Disclosure Interpretation Question 128D.07)*.

4. Date When Performance-Based Vesting Condition is Considered Satisfied Depends on Specific Facts and Circumstances

If an equity award containing a performance condition requires certification by the board of directors or the compensation committee that the target level of performance was attained, the provision should be analyzed to determine whether the award should be considered vested as of fiscal year-end or if the certification requirement creates an additional substantive vesting condition, such that an executive does not vest in the award unless and until the performance result has been certified (including awards that require the executive to remain employed through the date such certification occurs) *(see Compliance and Disclosure Interpretation Question 128D.19)*. The answer to this question will determine when the award's final "fair value" should be determined to calculate the CAP attributable to the award.

5. Absent Limited Exceptions, Changing the Composition of Custom Peer Group in Subsequent "Pay-Versus-Performance" Tables Requires Comparison of Company TSR to Both the New and Former Peer Groups

SEC rules require companies (again, other than SRCs) that select or otherwise use a different peer group from the peer group used in the prior fiscal year – that is, that add and/or remove a peer company – to explain, via footnote, the reason or reasons for the change and compare the company's cumulative TSR with the cumulative TSR of both the new peer group and the former peer group. The SEC Staff has indicated that there are two situations where a comparison between the new and former peer group is not required: (i) a company is omitted from the peer group solely because it is no longer in the industry or line-of-business or (ii) the changes in peer group composition are the result of the application of pre-established objective criteria (such as where the company has consummated a merger or other acquisition) *(see Compliance and Disclosure Interpretation Question 128D.27)*. In these two cases, the company must disclose the specific description of, and the bases for, the change, as well as the identities of the companies removed from the peer group.

6. Companies May Specifically Designate Only One Financial Performance Measure as the "Company-Selected Measure"

Companies may provide additional financial performance measures in the "Pay-Versus-Performance" Table beyond what is required, but such additional measures need to be designated as "supplemental." The SEC rules provide that, in addition to providing a company's TSR and net income in the "Pay-Versus-Performance" Table for each covered fiscal year, the company is also required to disclose an amount for each covered fiscal year attributable to an additional financial performance measure which in the company's assessment represents its most important financial performance measure used to link compensation actually paid to its NEOs to company performance (the "Company-Selected Measure," or "CSM"). While SEC rules contemplate that a company designate a single measure as its "CSM," it is not precluded from disclosing a second (or third) important financial measure in the "Pay-Versus-Performance" Table as long as the information is not misleading and does not obscure the required information. In the case of adding another such financial performance measure, this means labeling the measure as "supplemental," either in the table itself or in a footnote to the additional column.

7. Disclosure of Named Executive Officers Must Include All Individuals Who Were Named Executive Officers at Any Time During Covered Fiscal Year

In addition to disclosing the total compensation reported in the Summary Compensation Table ("SCT") and CAP for its principal executive officer(s) in the "Pay-Versus-Performance" Table, a company must also disclose the average SCT total compensation and CAP for its other NEOs. This group includes all individuals who were NEOs at any time during a covered fiscal year, not just the NEOs who were serving as such at the end of the last completed fiscal year. *Compliance and Disclosure Interpretation Question 128D.30* provides that where a company has multiple principal financial officers during a single covered fiscal year, each NEO must be included individually in the calculation of average compensation amounts. In addition, any individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the company at the end of the last completed fiscal year (that is, a former NEO) should also be included in the calculation.

8. Broad Equity Market Index May Not be Used to Calculate Peer Group Cumulative TSR

Although *Compliance and Disclosure Interpretation Question 128D.05* indicates that, for purposes of calculating cumulative TSR of its peer group, a company may use a peer group that is disclosed in its CD&A as used to help determine executive pay, even if such peer group is not used for "benchmarking" purposes, this guidance should not be read too broadly. The SEC Staff has indicated that this guidance does not permit a company to use a broad-based equity market index that it uses to determine the vesting of performance-based equity awards based on relative TSR *(see Compliance and Disclosure Interpretation Question 128D.25)*.

9. Smaller Reporting Companies That Lost This Status as of January 1, 2024 May Continue to Include Scaled Disclosure in 2024 Proxy Statements if Filed Within 120 Days of 2023 Fiscal Year-End

SRCs that lose their status as of January 1, 2024 would appear to no longer be eligible to use the "scaled disclosure" system provided in the SEC rules. However, the SEC Staff has indicated that in this initial year as an accelerated filer such a company may continue to include scaled disclosure in its proxy statement as long as it is filed not later than 120 days after its 2023 fiscal year end *(see Compliance and Disclosure Interpretation Question 128D.28)*. The "Pay-Versus-Performance" disclosure in this filing must cover fiscal years 2021, 2022, and 2023.

In addition, in subsequent "Pay-Versus-Performance" Tables (that is, in its proxy statement filed in 2025) where the company continues to not be a SRC, it must provide the full disclosure in its "Pay-Versus-Performance" Table for fiscal 2024 and may continue to provide the "scaled" disclosure for fiscal 2021, 2022, and 2023 (in other words, the company is not required to revise its disclosure for prior fiscal years to conform to non-SRC status in such filings). However, because peer group cumulative TSR is calculated on a cumulative basis, the company should include (a) peer group TSR for each fiscal year included in the "Pay-Versus-Performance" Table and (b) its quantifiable performance under its Company-Selected Measure for each fiscal year included in the table.

10. Emerging Growth Companies that Lost Status as of January 1, 2024 Should Probably Use Published Industry or Line-of-Business Index to Report Peer Group Cumulative TSR

Emerging growth companies ("EGCs") that lose their status as of January 1, 2024 (and which do not qualify as SRCs) must comply with the full "Pay-Versus-Performance" disclosure requirements. This means that their disclosure must include in the "Pay-Versus-Performance" Table (i) three years of information, (ii) their cumulative TSR and the cumulative TSR of their peer group, (iii) a Company-Selected Measure, and (iv) a Tabular List. For purposes of reporting the cumulative TSR of their peer group, the company is required to use as its peer group either the published industry or line-of-business index used for purposes of its stock performance graph or, if applicable, the companies it uses as a peer group for purposes of its CD&A. It appears that, in this situation, it may be simpler for the company to use the published industry or line-of-business index used in its stock performance graph (which disclosure is required of EGCs). The use of a compensation peer group is more problematic since, as an EGC, the company will not have included a CD&A in its previous proxy statements. However, it appears that it may be permissible for the company to use the compensation peer group that will be disclosed in its initial proxy statement as an accelerated filer.

Observations

While compliance with the "Pay-Versus-Performance" disclosure requirements should be easier than in 2023, there will still likely be challenges that companies have to address in preparing their "Pay-Versus-Performance" Table and related discussions of the relationship between the CAP to their NEOs and company performance. We expect that various stakeholders, who were relatively quiet in their reactions to the initial round of disclosure, may have more to say about the correlation between pay and performance with the benefit of an additional year of disclosure. We also expect now that companies have had an opportunity to view the disclosures of their peers and the broader market, there may be a movement towards greater harmonization of the disclosure among companies – at least in terms of formatting and presentation. Finally, since companies were largely left to their own devices in deciding what constituted "good faith" compliance in 2023, now that we are more familiar with the mechanics of compliance and have nearly three dozen interpretive responses from the SEC Staff on how the "pay-versus-performance" rule should be applied, we may see some companies shift their approach to take advantage of the SEC Staff guidance and to fit within the emerging "best practices" for this disclosure item.

Need Assistance?

Compensia has extensive experience in helping companies analyze the requirements of the SEC's "pay-versus-performance" disclosure rule, as well as drafting the required disclosure. If you would like assistance in preparing your "pay-versus-performance" disclosure, or if you have any questions on the subjects addressed in this Thoughtful Disclosure Alert, please feel free to contact the author of this Alert, Mark A. Borges at 415.462.2995 or mborges@compensia.com.

February 27, 2024

Performance-Based Equity Program Check-Up: Relative TSR Design Trends and Practices

Pressure from shareholders and institutional investor advisory groups to include stock performance metrics in incentive compensation plans, balanced with demand for a simple, yet durable approach to performance-based equity, has led to continued interest in programs that measure relative total shareholder return ("TSR"). Over the past few years, some of the core design parameters have evolved to strengthen the alignment of executive pay and performance while other terms have remained the same. Most notably, software companies lead in adopting these enhancements among the technology industry sectors.

Key changes include:

- **Bar raised on performance levels required for target and maximum payouts (i.e., above 50th percentile at target and above 75th percentile at max)**
- **Payout caps added for negative absolute TSR**
- **Adjustment in measurement approaches**

Other program terms have remained stable in new and existing plans:

- **Use of broad market indices as comparator benchmarks**
- **Longer performance periods than used for financial and operational metrics (e.g., cumulative 3 years)**

To ensure your relative TSR program remains aligned with market, this Alert highlights notable trends and key practices among our technology industry client base and the 103 technology industry companies in Compensia's July 2023 Tech 200 Database that awarded executives performance-based stock units ("PSUs") that included a relative TSR metric.

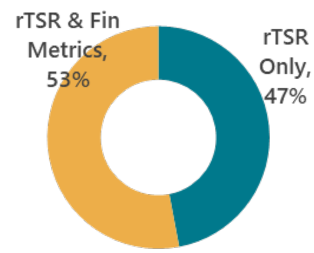
Background on Relative TSR PSUs

Relative TSR PSUs are simply RSUs that vest based on a company's change in stock price, plus dividends (if applicable) paid, over a pre-established performance period, measured against an appropriate index/peer group.

Why Companies Grant Relative TSR PSUs
✓ Captures investor's opportunity cost of investing in Company relative to the broader sector/ market
✓ Less sensitive to broad stock market fluctuations than options (since performance is relative)
✓ Provides a link to shareholder value creation
✓ Does not require setting long-term financial goals
✓ Avoids redundancy with bonus program goals
Reasons to Consider Not Granting
✕ May reward executives even if company does not meet financial/operational performance goals
✕ Comparator companies/index may be difficult to define
✕ Determining accounting grant value is somewhat more complex/less advantageous than for other vehicles
— Accounting expense is not generally reversible
— Design could drive accounting cost significantly higher or lower than target value

While these PSUs provide direct alignment with shareholders with respect to stock price returns, they are often supplemented with PSUs earned based on financial, operational or strategic metrics, as well as time-based vesting options or RSUs.

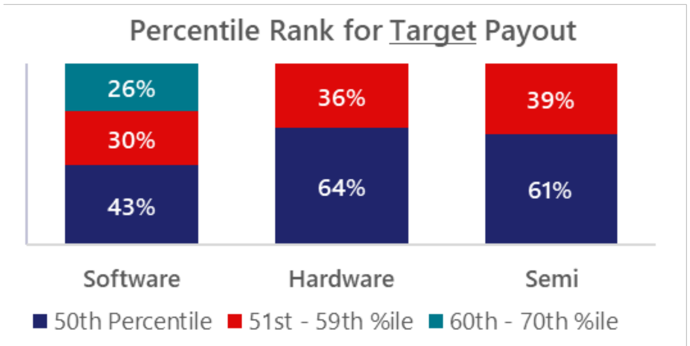
- **~64% of technology industry companies granting PSUs include a relative TSR metric**

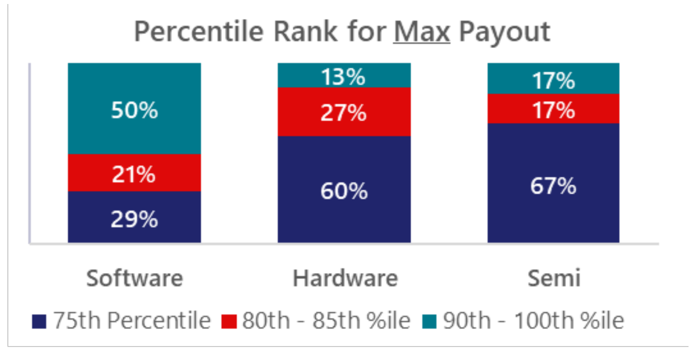


Where both relative TSR and financial metrics are weighted components of the plan formula (85% of the companies including both types of metrics), TSR accounts for, on average, 45% of the payout. The other 15% of companies use relative TSR results as a modifier to adjust payouts determined using financial or absolute stock price metrics, generally +/- 25 percentage points. No company eliminated a relative TSR metric for the current year, while 10 companies introduced relative TSR PSUs for the first time.

Performance Levels

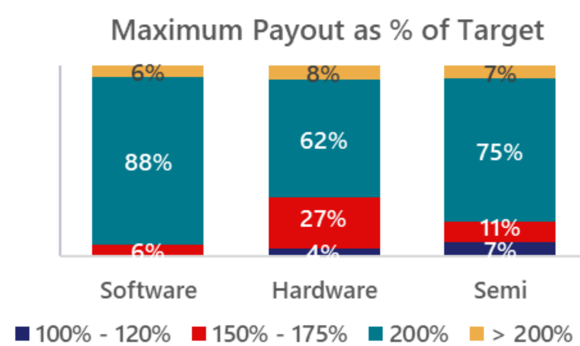
- **~50% of software companies require TSR above the median of the index for target payout (e.g., 55th – 60th percentile) and at or above the 90th percentile for maximum payout**
- **Other industries are slower to adopt more rigorous performance requirements**





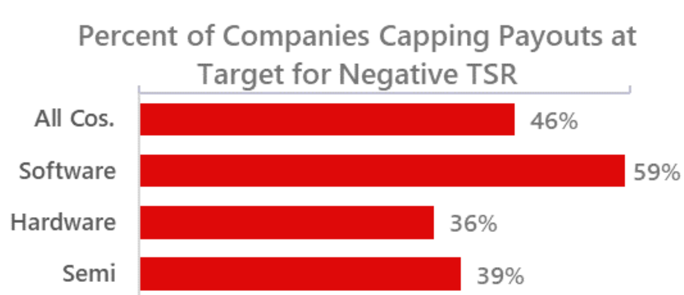
Performance requirements are becoming more rigorous, with companies raising the bar from the standard structure of setting threshold payout at the 25th percentile, target payout at the median/ 50th percentile and maximum payout at the 75th percentile.

In response to ISS' and Glass Lewis' belief that companies should "outperform the index" to earn target level awards, and Compensation Committees' desires to strengthen the alignment between pay and performance, there has been a 70% increase in the number of companies targeting higher percentiles. Hardware and semiconductor industries are slower to embrace this trend; however, these industries provide for less upside payout opportunities. Among software companies, 94% set the maximum payout at or above 200% of target, as compared to 69% of hardware industry companies and 82% of semiconductor industry companies. Threshold payout for achieving 25th percentile TSR remains most common (70% - 80% among all industry sectors).



Payout Cap for Negative Absolute TSR

- **Nearly 50% of companies cap payouts at target if absolute TSR is negative**



Capping payouts at target for negative absolute TSR is viewed favorably by advisory groups, serves as a risk mitigator and strengthens the alignment of plan payouts with company shareholders.

Measurement Approach

- **Percentile Rank remains most common measurement approach (70%)**
- **Rise in the number of companies considering or implementing a Percentage Points vs. Index (25%) or Points vs. Median measurement approach (5%)**

Each of these approaches comes with tradeoffs in terms of understandability and alignment. Three approaches used to determine relative TSR PSU payouts include:

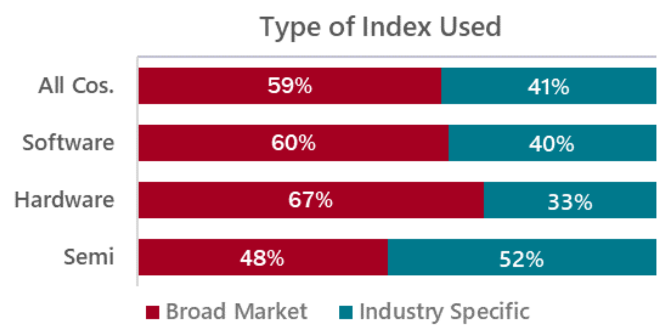
Approach	Advantages	Disadvantages
Percentile Rank vs. Index *Company's percentile rank against the individual index constituents*	▲ Easiest to explain to participants ▲ More direct "pay for performance" link as the actual percentile performance required for payout is known ▲ Avoids potential impact of more heavily weighted index components	▼ Percentile performance rank could be wide or narrow depending on constituents ▼ Difficult to track and measure performance without assistance of 3rd party vendor ▼ More difficult to scale down payout / capture a wide range of performance (plans typically designed to pay above the 25th percentile)
Points vs. Index *Outperformance or underperformance against overall Index*	▲ Easiest to track performance ▲ Generally results in lower accounting valuation ▲ Does not require addressing M&A	▼ Pay and performance outcomes more difficult to explain and not aligned in all markets ▼ May be significantly influenced by heavily weighted constituents ▼ Challenging to set payout curve
Points vs. Median *Outperformance or underperformance against the median TSR of the index constituents*	▲ Balances setting target performance equal to the index TSR that may be significantly influenced by more heavily weighted constituents, with the flexibility to set the range (i.e., within X% points of the index median)	▼ Not a common design ▼ More complicated to explain ▼ Difficult to track and measure performance without assistance of 3rd party vendor

With select indices becoming increasingly weighted toward a small group of highly-valued companies (i.e., top 10 constituents represent 30% of the S&P 500; Apple, Microsoft, Amazon, NVIDIA, Alphabet and Meta represent 40% of the NASDAQ), more companies are questioning the impact of using a percentile rank approach on the plan outcomes.

Comparator Index

- **90% of companies use an independently-constituted index vs. a custom peer group, most often a broad market industry**

A market index supports a transparent process, eases program communication and reduces year-over-year plan design changes. Despite shareholder requests to tailor the relative TSR benchmark to an industry or line-of-business focused index, most software and hardware companies continue to use the S&P 500 or Russell 2000/3000.



Performance Periods

- **68% of companies measure performance over a cumulative 3-year period with all earned shares vesting upon award determination**

Multiple performance periods are most often used at recently public companies or those adopting relative TSR PSUs for the first time. An overlapping 1-, 2- and 3-year performance period approach, all measured from the same starting point, is most common. In calculating TSR, an averaging period of between 30 and 90 days at the beginning and end of the performance period is typical practice to mitigate the impact of price volatility on outcomes.

Need Assistance?

Compensia has extensive experience in helping companies design performance-based equity programs aligned with the pay program objectives, market practices and shareholder preferences. If you would like assistance in reviewing your existing programs, developing a new performance-based equity program, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact **Jodie Dane at 415.462.1985 or jdane@compensia.com.**

CCR corp
DIRECT FROM THE EXPERTS

THE CORPORATE EXECUTIVE

Founding Publisher: Jesse M. Brill

8911 N. Capital of Texas Highway, #4200-110, Austin, TX 78759

THE NEWSLETTER FOR THOSE THAT ADVISE PUBLIC COMPANIES

VOL. 37, NO. 4

SEPTEMBER-OCTOBER 2023

Clawback Policy Listing Standards: Frequently Asked Questions

Renewal Reminder: Ensure Uninterrupted Access to Your CCRcorp Membership

A Word from the Editor

The compensation clawback requirements contemplated in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 have been covered in great detail in the pages of The Corporate Executive for some time. This continuing coverage has been justified, because there is perhaps nothing more concerning to corporate executives than the prospect of having their compensation clawed back after they have earned, received and paid taxes on that compensation. While the notion of implementing compensation clawbacks has been laudable, given the underlying concern that executive officers should not be allowed to keep compensation that they were not entitled to, the evolution of the Dodd-Frank clawback requirement from statutory directive to SEC rule to exchange listing requirement has ultimately left us with a lot of open questions. As we have recently noted (see the September-October 2022, January-February 2023 and May-June 2023 issues of The Corporate Executive), the SEC's clawback directive in Rule 10D-1 turned out to be very prescriptive, and the New York Stock Exchange and Nasdaq listing requirements closely follow that prescriptive Rule 10D-1 model. As a result, we now have new clawback policies that closely hew to largely untested elements contemplated by the SEC and the exchanges, and implementing those elements in real life will likely prove to be challenging for listed companies for years to come.

Beginning on page 2, we dive into the frequently asked questions that we have been encountering in our practice, the CompensationStandards.com Q&A Forum and other venues, as well as important issues that were addressed by the panel of experts joining us for our recent webcast "More on Clawbacks: Action Items and Implementation Steps." We address, for example, the interpretation of several of the terms that are key to the operation of the new clawback policies, the scope and timing of required clawback provisions, the incentive-based compensation that is covered by new clawback policies, the board's discretion (or lack thereof) in implementing new clawback policies and a wide variety of implementation challenges that listed companies may have to consider now that these new clawback policies are in effect. We also address some of the thornier issues of indemnification and tax consequences that both listed companies and their executive officers should consider before any clawback is triggered.

With much of the focus over the past few months on just getting a compliant clawback policy adopted, now comes the hard part of sorting out when and how these new clawback policies will be applied and the far-reaching implications on executive compensation. We hope these FAQs will assist you on your journey and we will provide continuing coverage of this topic as new questions emerge.

– DL

Clawback Policy Listing Standards: Frequently Asked Questions

By John Jenkins, Managing Editor, TheCorporateCounsel.net

As we discussed in the May-June 2023 issue of *The Corporate Executive*, Nasdaq and the NYSE finalized the clawback listing standards mandated under Exchange Act Rule 10D-1. Those rules became effective on October 3, 2023, and listed companies were required to have a compliant policy in place no later than December 1, 2023. The compliance date is now in the rearview mirror, and companies face the prospect of having to navigate their way through the compliance challenges posed by the listing standards and the clawback policy they mandate.

We provided a comprehensive overview of the clawback rules and our own model clawback policy in that issue, but several months have passed since then and many additional questions have arisen about the listing standards. Since that is the case, we thought our readers might find it helpful if we used this issue to address some of the questions about Rule 10D-1 and the clawback listing standards that have been raised by CompensationStandards.com members in our Q&A Forum or in other venues. We have supplemented our responses to those questions with guidance provided by various law firm publications on Rule 10D-1 and the listing standards, as well as insights provided by our expert panel in our recent "More on Clawbacks: Action Items and Implementation Steps" webcast.

What are the differences between clawback requirements under Section 304 of Sarbanes-Oxley and the clawback policy mandated under the Nasdaq and NYSE listing standards?

Section 304 of the Sarbanes-Oxley Act gives the SEC authority to require recovery of any bonus, incentive-based pay or stock sale profits received by a company's CEO or CFO within 12 months of a financial statement filing in the event of material noncompliance with financial reporting requirements resulting from misconduct. For compensation to be recoverable under Section 304, the noncompliance with the financial reporting requirements must result from misconduct by someone in the company; however, Section 304 allows for complete disgorgement of incentive pay, not just the incremental amount associated with the faulty accounting.

The clawback policy mandated by Rule 10D-1 and the exchanges' listing standards implements the requirements of Section 954 of Dodd-Frank. In contrast to Section 304 of Sarbanes-Oxley, the clawback policy required under Dodd-Frank must apply to all of the company's executive officers and provide for the recovery of up to three fiscal years of incentive compensation. Misconduct is also not required to recover erroneously awarded incentive compensation.

In addition, only the SEC has the authority to compel a clawback under Section 304, while the mandatory Dodd-Frank clawback policy will require the company itself to take that action; however, the amount of incentive compensation at risk under the clawback policy is limited to erroneously paid incentive compensation, while all incentive compensation is potentially at risk under Section 304 of Sarbanes-Oxley.

What compensation must be subject to recovery for a clawback policy to comply with Rule 10D-1 and the exchange listing standards?

Rule 10D-1 requires the policy to address the recovery of erroneously awarded "incentive-based compensation," which the rule defines as "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure." In turn, the rule defines "financial reporting measures" as "measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, and any measures that are derived wholly or in part from such measures."

The SEC's adopting release for Rule 10D-1 sets forth nonexclusive examples of "incentive-based compensation":

- Non-equity incentive plan awards that are earned based wholly or in part on satisfying a financial reporting measure performance goal;
- Bonuses paid from a "bonus pool," the size of which is determined based wholly or in part on satisfying a financial reporting measure performance goal;
- Other cash awards based on satisfaction of a financial reporting measure performance goal;
- Restricted stock, RSUs, PSUs, stock options and SARs that are granted or become vested based wholly or in part on satisfying a financial reporting measure performance goal; and
- Proceeds received upon the sale of shares acquired through an incentive plan that were granted or vested based wholly or in part on satisfying a financial reporting measure performance goals.

Securities Act Release No. 33-11126, *Listing Standards for Recovery of Erroneously Awarded Compensation*, (Oct. 26, 2022) (the "Adopting Release") at 64.

There is an exception in the rules that would allow companies to refrain from recovering incentive-based compensation paid to tax-qualified retirement plans if recovery of that compensation would likely cause a tax-qualified retirement plan, under which benefits are broadly available to employees, to fail to meet applicable legal requirements.

What are some examples of "financial reporting measures"?

The Adopting Release provides nonexclusive examples of financial reporting measures. These include revenue, net income, operating income, profitability of one or more segments, financial ratios (such as receivables and inventory turnover rates), EBITDA, FFO and adjusted FFO, liquidity measures such as working capital and operating cash flow, and return measures such as ROIC and ROA. For registered investment companies and business development companies, financial reporting measures may also include net asset value ("NAV") per share.

Rule 10D-1 also specifically includes stock price and total shareholder return ("TSR") within the definition of financial reporting measures, and notes that such measures need not be presented within the company's financial statements or included in its SEC filings.

How far back must the clawback policy provide for the recovery of erroneously awarded incentive-based compensation?

Rule 10D-1 provides that erroneously awarded incentive-based compensation must be subject to recovery if it is "received" during the three completed fiscal years immediately preceding the date on which the company "is required to prepare an accounting restatement." Rule 10D-1 goes on to say that incentive-based compensation is deemed "received" in the fiscal period during which the financial reporting measure specified in the award is attained, even if the payment or grant of that compensation is after the end of that period.

Because the date of receipt is tied to the date that the applicable financial reporting measure is attained, awards that are contingent upon both the attainment of such a measure and time-based vesting will be deemed to have been received when that financial reporting measure is obtained, regardless of whether sufficient time has elapsed for the award to vest.

On what date is a company deemed to be "required to prepare an accounting restatement" for purposes of applying the clawback policy?

Rule 10D-1(b)(1)(ii) provides that the date a company is deemed to be required to prepare an accounting restatement is the date that its board, board committee or authorized officer(s) "concludes, or reasonably should have concluded" that it is required to prepare an accounting restatement, or the date that a court, regulator or other legally authorized body directs the company to prepare an accounting restatement.

What kind of accounting restatements must the clawback policy apply to?

Rule 10D-1(b)(i) provides that the clawback policy must require the recovery of any erroneously awarded incentive-based compensation that results from an accounting restatement due to the "material noncompliance of the issuer with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period." That definition is broad enough to cover both restatements involving the reissuance of financial statements ("Big R" restatements) and those that merely require the revision of previously issued financial statements ("little r" restatements).

A "Big R" restatement is required when it is determined that an error is material to the relevant prior period. In that case, the previously issued financial statements for that period may no longer be relied upon and the company must notify users of the financials of that fact, as well as the fact that the auditor's opinion on those financial statement also may no longer be relied upon. To correct the error, the prior period financial statements must be reissued.

In contrast, when an error is immaterial to the relevant prior period, but correcting the error in the current period would result in a material misstatement of the current period's results, it is corrected through a revision, or "little r" restatement, which corrects the error in the current year's comparative financial statements by adjusting the prior period financial statements and including disclosure of the error.

There is a third manner in which an error in the financial statements may be corrected: an out-of-period adjustment. If an error is clearly immaterial to both the current period and the prior period during which it occurred, then it may be treated as an out-of-period adjustment and corrected solely in the current period. Rule 10D-1 focuses on material misstatements in prior or current period financial statements and does not extend to clearly immaterial errors, so an out-of-period adjustment should not trigger an obligation to recover incentive compensation under a clawback policy.

Finally, not all restatements arise out of a need to correct an error in the financial statements. For example, a change in accounting principles requiring retroactive application will require a company to restate prior period financial statements to reflect that change. Restatements such as these that do not involve the correction of an error do not implicate the clawback policy mandated by exchange listing standards.

If a company restates interim financial statements by filing Form 10-Q/As, is it required to check the new box on the Form 10-K cover page?

The Staff informally addressed this topic during a June 2023 meeting with members of the Center for Audit Quality's SEC Regulations Committee. The Staff indicated that if financial statements included in the 10-K are not required to disclose the correction of an error because the error only existed in interim periods, it would not object to an issuer's decision not to check the box on the Form 10-K. See *CAQ SEC Regulations Committee Highlights — Joint Meeting with SEC Staff* (June 15, 2023).

What types of compensation do not have to be made subject to recovery under the terms of a clawback policy?

The listing standards do not require a clawback policy to provide for the recovery of base salary, discretionary cash bonuses that are not based on the attainment of a financial reporting measure, time-vested RSUs and other equity-based awards that vest solely based on the passage of time or continued employment.

Note that the inclusion of *any* financial metric relating to a particular item of compensation, even if those are subject to adjustment in the compensation committee's discretion, will result in any such item of incentive compensation being regarded as subject to the clawback policy.

As this excerpt from a Cleary blog on the listing standards explains, documenting the rationale for a particular award is essential to minimize potential uncertainty concerning whether a particular item of compensation is subject to recovery under the clawback policy:

> "[C]ompanies should carefully evaluate whether specific forms of compensation would potentially be subject to clawback, as the line can be thin between compensation considered to be 'granted, earned, or vested in part upon the attainment of any financial reporting measure' and compensation that is discretionary or based on a subjective standard. Companies and their advisors should also be thoughtful as to how they document their processes, procedures and rationale for granting compensation, as the description of the compensation and how it was determined could potentially impact whether the compensation is subject to recovery."

Cleary M&A and Corporate Governance Watch, *ClawFAQs: Common Clawback Questions*, (October 3, 2023).

What compensation programs may include elements of incentive-based compensation?

Our webcast panelists observed that any component of an executive's compensation for which the amounts payable are calculated in part on the basis of the total compensation an employee received are likely to include a portion that is attributable to an incentive-based compensation. That may result in the need for the clawback policy to be applied to a wider range of compensation programs than many companies may expect.

For example, a portion of amounts payable under long-term disability, life insurance, SERP severance plans and other forms of compensation where the formula for determining the amounts payable is based in part on the total compensation received by an executive may be subject to recovery. Companies with plans like these should review them to determine whether incentive compensation that is earned by executives is factored into the payout formula. If so, and if some of that incentive compensation is required to be recovered, then the payments made or to be made in the future under those plans may need to be adjusted.

How is the amount of erroneously paid incentive-based compensation calculated?

The policy must provide for the recovery of all incentive-based compensation received that exceeds the amount that otherwise would have been received by the executive had it been determined based on the restated amounts. That amount must be computed without regard to any taxes paid.

In situations involving incentive-based compensation that is determined based on the company's stock price or TSR, the amount of erroneously paid incentive compensation may not be directly determinable from information in the accounting restatement itself. In these cases, Rule 10D-1 requires the amount recovered to be based on a reasonable estimate of the effect of the accounting restatement on the stock price or upon which the incentive-based compensation was received. The rule also requires the issuer to maintain documentation as to how it determined that reasonable estimate and provide it to the appropriate stock exchange.

One area that is not addressed in Rule 10D-1 or the listing standards is how an issuer should determine the amount to be recovered in the case of sales of stock originally issued to an executive as incentive compensation. This excerpt from Latham's memo on the rules addresses that scenario:

> "While the SEC's proposed clawback rules issued in 2015 provided that if the excess shares have been sold, the recoverable amount would be the sale proceeds in respect to the excess number of shares, the final SEC Clawback Rules do not specifically address this treatment and do not expressly mandate the recovery of gains on the sale of shares that are excess incentive compensation. Instead the SEC's release provides that the determination will depend on the particular facts and circumstances applicable to that company and the executive officer's particular compensation arrangement and that companies and their boards will be in the best position to make these determinations."

Latham & Watkins Client Alert, *SEC Clawback Rules: Practical Considerations and FAQs* (October 20, 2023).

Our webcast panelists said that this is an area where market recovery practices will have to develop, and that they expect some companies will initially take the position that shares are fungible and simply take a number of shares equivalent to the amount of the award required to be recovered from the executive's other holdings; however, they also noted that given the uncertainty in this area, close attention needs to be paid to the language contained in the policy. That language should avoid ambiguity and make it clear as to what gain is regarded as being "realized" for purposes of applying that policy. For example, a policy that says "any gain realized from vesting, exercise, transfer or sale" of equity securities creates uncertainty as what gain is regarded as "realized" under the policy.

Is there any way to mitigate the consequences to the executive of the requirement that the amount to be recovered under the clawback policy must be computed without regard to taxes paid?

While provisions of Section 1341 of the Internal Revenue Code may permit an executive that has repaid income received and recognized in a prior year to receive a tax deduction or credit for the year in which that income is recovered, companies may also want to consider permitting executives to defer a portion of their incentive-based compensation. This excerpt from Latham's memo explains:

> "Due to the requirement to recover compensation on a pre-tax basis, companies may choose to implement deferral arrangements that give executive officers the election to defer payment of incentive-based compensation that is potentially subject to clawback until a date after the expiration of the recovery period. If properly structured, these types of delayed payments can potentially allow for a potential future clawback to draw from deferred amounts that have not yet

been paid or subject to income tax, which may facilitate recoupment efforts because recovery is required on a pre-tax basis. Any deferral arrangements will need to be carefully reviewed in light of Section 409A of the Internal Revenue Code."

Latham & Watkins Client Alert, *SEC Clawback Rules: Practical Considerations and FAQs* (October 20, 2023).

Does the board have any discretion in applying the clawback policy?

Rule 10D-1 and the listing standards sharply limit the board's discretion in applying the clawback policy. The board or a committee may only determine not to seek recovery of compensation subject to the rule if it determines that such recovery would be impractical due to three enumerated circumstances:

- The direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered. Before determining that recovery is impractical on this basis, the issuer must make a reasonable attempt to recover the compensation, document those efforts and provide that documentation to the exchange.
- Recovery would violate a law of the issuer's home country that was adopted prior to November 28, 2022. Before determining that recovery is impractical on this basis, the issuer must obtain an opinion of home country counsel acceptable to the exchange that recovery would violate the law, and it must provide that opinion to the exchange.
- Recovery would likely jeopardize the qualified status of an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the registrant.

The determination that the clawback would be impractical under one or more of the foregoing standards must be made by the compensation committee or, in the absence of such a committee, by a majority of independent directors.

Does the board have discretion with respect to the terms under which erroneously paid incentive-based compensation will be recovered?

In the Adopting Release, the SEC said that it recognized that "the appropriate means of recovery may vary by issuer and by type of compensation arrangement" and it further stated its agreement with commenters that "many different means of recovery may be appropriate in different circumstances." As a result, issuers are permitted to exercise discretion as to how they recover erroneously paid incentive-based compensation. Methods of recovery that commenters on the rule proposal endorsed include canceling unrelated unvested compensation awards, offsets against nonqualified deferred compensation and unpaid incentive compensation, future compensation obligations or dividends on company stock.

However, the Adopting Release notes that in exercising this discretion, issuers should act in a manner that effectuates the statutory purpose of preventing covered personnel from retaining compensation to which they were not entitled under the issuer's restated financial results. In addition, issuers must recover such compensation "reasonably promptly" to avoid the ability of executives to capture the time value of money that does not rightfully belong to them.

What incentive compensation metrics may create particularly complex issues in determining the appropriate amount subject to recovery?

Unfortunately, our webcast panelists pointed out that some of the most commonly used incentive compensation plan metrics may create the most difficulty when it comes to determining how much compensation should be recovered in the event of a restatement. For example, although many plans include stock-based awards and performance measures that are based on stock price or TSR, those metrics may necessitate complex calculations in the event of a restatement.

Item 402(w) of Regulation S-K requires proxy disclosure concerning a company's action to recover erroneously awarded incentive-based compensation, and that if the financial metric used to determine incentive compensation was TSR or stock price, then that disclosure must address "the estimates that were used in determining the erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates." This disclosure requirement and the potential for second-guessing by the plaintiffs' bar means that boards need to proceed cautiously and be prepared to defend their approach when determining the amount of compensation recoverable for awards based on stock price or TSR.

The extent of the analysis required in developing this approach will likely vary depending on the potential amounts involved. In cases involving relatively small potential recoveries, the panelists suggested that companies may opt for a shorthand approach, such as one that determines the amount to be recovered by applying the pre-restatement trading multiple to the post-restatement earnings per share. If the stakes are higher, companies may be better served by using a process similar to the expert valuation approaches used in class action litigation to assess the impact of a disclosure issue on a company's stock price.

What does the requirement to recover compensation "reasonably promptly" mean?

Rule 10D-1 and the listing standards do not define the term "reasonably promptly." In the Adopting Release, the SEC stated that it recognizes that reasonableness may depend on the additional costs associated with recovery efforts and that it expects issuers will, consistent with the fiduciary duties of their directors and officers, pursue "the most appropriate balance of cost and speed in determining the appropriate means to seek recovery."

Should the clawback policy be adopted by the board or the compensation committee?

We think that the answer to this question will vary from company to company. For example, companies that have not already updated their compensation committee charters to delegate clawback responsibilities to that committee may opt to have the full board adopt the policy, while those that have already delegated responsibility for clawbacks to the compensation committee may leave it to that committee to authorize a new policy.

Regardless of whether the full board or a committee adopts the policy, the full board should have an oversight role in assuring that management has put in place adequate controls and procedures to effectively implement compensation clawbacks if they become necessary. A board committee can certainly take the lead in that oversight effort, but clawbacks are a high-profile issue with investors and the optics of the full board being involved in providing this kind of oversight are better than an approach where the board delegates those responsibilities entirely to a board committee.

Which board committee should administer the clawback policy?

We expect that responsibility for administering the clawback policy will fall to the compensation committee of the board of directors; however, our webcast panelists observed that although the compensation committee will typically have responsibility for managing the clawback policy, the audit committee and the company's auditors will be responsible for managing the restatement process. Close coordination between the compensation committee and the audit committee will be necessary, and the company should consider how that process will be managed before it is faced with a potential restatement that could trigger a mandatory recovery under the policy.

Must the clawback policy provide for the recovery of incentive-based compensation received prior to the October 2, 2023, effective date of the NYSE and Nasdaq listing standards?

No, footnote 384 to the Adopting Release says that an issuer is only required to apply its policy to incentive-based compensation received after the effective date of the applicable listing standard. The key date is the date that the incentive compensation is received, not when the award itself was made. An award that was granted prior to the effective date of the listing standard but was not received until after that date would be subject to recovery.

If incentive-based compensation is received by an executive officer who was not an executive officer at the time of the award, is the company required to recover that compensation if it is erroneously paid?

Companies are only required to recover erroneously awarded incentive-based compensation received after a person begins to serve as an executive officer. Specifically, Rule 10D-1 and the listing standards require recovery of incentive-based compensation received by a person: (i) after beginning service as an executive officer, and (ii) if that person served as an executive officer at any time during the recovery period. Recovery of compensation received while serving in a non-executive officer capacity prior to becoming an executive officer will not be required.

Will insurance be available under D&O policies for compensation required to be recovered under the listing standards?

Rule 10D-1 prohibits indemnifying officers for incentive compensation subject to recovery under the clawback policy, and also explicitly prohibits a company from paying or reimbursing premiums for an insurance policy on behalf of officers subject to the clawback policy. According to a recent Aon memo, the firm expects that insurers will continue to provide coverage for costs and expenses associated with recoveries required under a Dodd-Frank mandated clawback policy through Side A Difference-in-Conditions ("A/DIC") policies. Aon Financial Services Group, *How the SEC's Final Clawback Rule Affects D&O Insurance Coverage*, (June 2023).

The Adopting Release stated the SEC's belief that Section 29(a) of the Exchange Act would render any indemnification agreement void. What about charter and bylaw indemnification provisions?

We think the SEC will take the same position as to corporate charters and bylaws, and would point to state corporate law cases with language referring to those documents as contracts. For example, Vice Chancellor Laster observed in *Opportunity Partners v. Hill International*, C.A. No. 11025–VCL (Del. Ch. 2015):

> "The bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the [Delaware General Corporation Law]."

Should companies amend their charter provisions or indemnification agreements to address the requirements of the clawback policy mandated by NYSE and Nasdaq listing standards?

As a result of the clawback provisions of Section 304 of the Sarbanes-Oxley Act, many existing forms of indemnity agreements include language that excludes recovery of incentive compensation from their coverage. In light of that existing language, some companies may conclude that amending existing indemnification provisions in their charter documents and indemnity agreements is not necessary.

Nevertheless, given the fact that Rule 10D-1 contains an express prohibition on indemnifying executive officers for the recovery of incentive-based compensation, we think it is prudent to review existing charter and contractual provisions to ensure that existing exclusions are sufficiently broad to cover the requirements of Rule 10D-1 and the NYSE and Nasdaq listing standards. Making this prohibition explicit in charter documents and indemnification agreements could help avoid litigation by current or former executives alleging that they have a contractual right to indemnification for recovered incentive-based compensation.

Should companies amend existing compensation plans or award agreements to address these requirements?

Terms of compensation plans or award agreements that are inconsistent with the requirements of the clawback policy mandated by NYSE or Nasdaq listing standards present a somewhat different situation than indemnification agreements and charter provisions. While indemnification for recovered incentive-based compensation is likely barred by Section 29(a) of the Exchange Act, absent a contractual right to recover such erroneously paid compensation from an executive officer, a company may face significant challenges in complying with its obligations. We think companies should amend the terms of plans and award agreements if necessary to conform to the requirements of their clawback policy.

In that regard, in June 2023, a federal district court judge issued an unpublished opinion in *Hertz Corp. v. Frissora*, (D.N.J. June 26, 2023), a long-running clawbacks case involving a former executive officer of Hertz Corporation (see the May-June 2023 issue of *The Corporate Executive* at page 1). The judge rejected the company's efforts to enforce a clawback policy in a situation where its requirements were not addressed in the terms of the executive's employment agreement. The decision emphasizes the importance of following state law contract principles when a company puts a policy in place if it wants to be able to enforce the company's rights under that policy down the road.

Should companies include a "reverse clawback" provision in their clawback policy for situations where a restatement shifts income from one period to another and increases the amount of an award payable in a particular period?

We think that such a provision is unlikely to be necessary, because the executive would likely have a contract right to receive the increased amounts under the terms of the plan and the applicable award agreement. If any adjustments are appropriate to clarify that right, we think the better place for them is in the plan or the award agreement, and not in the clawback policy itself.

We already have a clawback policy. Should we amend that policy to conform to the clawback listing standards or should we adopt a separate policy?

In addition to our discussion of this topic in the May-June 2023 issue of *The Corporate Executive* at page 1, we think this excerpt from a recent Faegre Drinker memo provides a comprehensive response to this question:

> "When deciding between one or two policies, there are several factors to consider. To make this determination, issuers should first compare the listing requirements to their existing policies. If the current policy closely aligns with the new requirements, it can be updated or replaced accordingly. Companies with a discretionary policy covering a broader group than Section 16 officers, a wider set of compensation (for example, all

incentive compensation, including time-based and discretionary awards, is subject to clawback, and/or the amount recovered may be all incentive compensation, not just the difference as a result of an accounting restatement), events not relating to nonmaterial financial statements, or provisions for misconduct or negligence may want to adopt a two-policy framework. Companies may also prefer to keep their policies applying to a wider group of employees confidential.

"Many issuers are choosing to use two policies — the required clawback policy supplemented by a more flexible and discretionary clawback policy tailored to the company's specific circumstances. While it is possible to have one policy with two parts, having separate policies — one that is limited to what is required and another that is tailored to the company's particular circumstances — may provide greater flexibility to amend when circumstances change, greater clarity with respect to related disclosure requirements, and more leeway in the timing for adopting the tailored policy. Although two policies may create additional compliance burdens and potential confusion, many companies have experience with multiple policies applicable to different groups (such as an additional, separate code of ethics for senior financial officers) and will find this to be a preferred approach in this context as well."

Yana S. Johnson and Elizabeth A. Diffley, Faegre Drinker Insights: *SEC Clawback Update: Listing Requirements for NYSE and Nasdaq Exchanges, and Preparing for Compliance*, (September 6, 2023).

Is the clawback policy required to provide for recovery of erroneously paid compensation in the event of restatements covering years prior to the company's IPO?

It depends on when the erroneous incentive compensation was "received" (which for purposes of the listing standards is likely going to mean the date on which the targets were achieved). Rule 10D-1 provides that an issuer's clawback policy must provide for the clawback of any erroneously awarded incentive-based compensation received "while the issuer has a class of securities listed on a national securities exchange or a national securities association …" So, if the incentive-based compensation was received after listing, it will be subject to a clawback. See footnote 206 to the Adopting Release:

> "After considering comments, we continue to believe that the statute calls for recovery limited to compensation that is received while the issuer has a class of securities listed on an exchange or an association. We note that an award of incentive-based compensation granted to an executive officer before the issuer lists a class of securities will be subject to the recovery policy, so long as the incentive-based compensation was received by the executive officer while the issuer had a class of listed securities. Incentive-based compensation received by an executive officer before the issuer's securities become listed is not required to be subject to the recovery policy."

Will amendments to a clawback policy trigger questions about whether the original policy complied with the listing standards?

Our webcast panelists discussed this issue and noted that as companies gain experience with the application of clawback policies, many may elect to amend their policies to address unresolved issues or to conform to emerging best practices or interpretive guidance. Their consensus was that amendments to a clawback policy along these lines should not raise concerns about whether the original version of the policy complied with the applicable listing standard.

Are foreign private issuers required to adopt clawback policies meeting the same requirements as domestic issuers?

Yes, foreign private issuers ("FPIs") must adopt clawback policies that conform to stock exchange listing standards. Despite the fact that all other compensation-related matters are governed by the laws of the FPI's home country, the SEC did not opt to exempt them from compliance with the clawback rules when it adopted Rule 10D-1.

As this excerpt from a recent article explains, the SEC's decision to require the clawback policy to apply to "executive officers" within the meaning of Rule 10D-1 creates added complexity for FPIs in determining which positions should be subject to the policy:

> "[I]n developing a clawback policy, FPIs will have the additional burden of developing procedures and controls that identify those positions to which the policy will apply. US issuers are well accustomed to identifying their corporate officers for purposes of the rules under Section 16. FPIs, on the other hand, generally have had no reason to identify their officers for this purpose. The title 'executive officer' is common in US business circles and a specific term of art under Rule 3b-7. The title is not necessarily typical outside the United States, as evidenced by the fact that Form 20-F largely avoids the term and refers instead to "senior management," i.e., those members of the company's administrative, supervisory, or management bodies."

Paul Dudek, *The Unique Impact of Recent SEC Rules on Foreign Private Issuers*, 56 Review of Securities & Commodities Regulation 16, 227 (Sept. 23, 2023) at 229.

Renewal Reminder: Ensure Uninterrupted Access to Your CCRcorp Membership

Have you renewed your membership? If you haven't received your renewal invoice or need any help with the renewal procedure, our dedicated Customer Service team is ready to assist you.

Feel free to reach out to us at 800-737-1271 or via email at info@ccrcorp.com. Ensuring your membership is up-to-date will guarantee uninterrupted access to our latest updates, practical guidance, industry insights and valuable content.

FOUNDING PUBLISHER - Jesse M. Brill, J.D. Yale Law School

Brill is recognized as one of the country's leading authorities on insiders' transactions and executive compensation practices and disclosure.

EDITORS

Dave Lynn, Senior Editor of TheCorporateCounsel.net and former Chief Counsel of the SEC's Division of Corporation Finance

Michael Gettelman, LL.B. Harvard University

CCRcorp • 8911 N. Capital of Texas Highway, #4200-110 • Austin, TX 78759 • 1-800-737-1271 • info@ccrcorp.com

← Say-on-Director-Pay: "Double Binding" Bylaw Proposals on the Ballot | Main | Early Bird Registration for Our Conferences Ends May 31st! →

May 1, 2024

Say-on-Pay: Things Are Looking Up!

Average say-on-pay support for Russell 3000 companies is sitting at 91% so far this year – with only 1 failure – which is trending higher than last year's results. That's according to this WTW snapshot from last week. The update also notes:

> – Last year's season-long failure rate was 2%, based on a total of 53 failed votes, compared to 1% so far this year
>
> – ISS is issuing fewer negative vote recommendations (8% this year vs. 13% last year)
>
> – Pay-for-performance continues to be the biggest driver of ISS "against" recommendations

Depending on when the snapshot is taken, S&P 500 companies are either experiencing similar results (per the WTW snapshot) or lagging slightly behind (according to this Semler Brossy report that's available for download).

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2024/05/say-on-pay-things-are-looking-up-2.html

Checklist: ESG as an Executive Compensation Performance Component

By CompensationStandards.com

1. **Understand the commitment**. Including ESG metrics in executive compensation is an emerging trend, but ESG is not well defined or understood. When evaluating ESG-based executive compensation components, it is critical to understand the commitment. Key considerations include:

    a. **Why was the decision made?** ESG goal-setting is often done in response to one or more of:

        i. Executives choosing to personify the corporate ethos

        ii. Building on existing sustainability commitments and disclosures

        iii. Current program inadequate or incomplete to motivate strategic ESG goals (e.g., lengthening the time horizon of existing financial metrics or according a heavier weight to long-term metrics is still not enough to incentivize and communicate ESG priorities)

        iv. Response to shareholder pressure/engagement

        v. Response to brand/reputation risk

        vi. Response to employee or community pressure/engagement

        vii. Response to other short- or long-term business risk

        viii. Moves by industry peers

        ix. An element of regulatory enforcement, as with a high-profile 2021 case against boohoo Group in the UK. Moves by the Securities and Exchange Commission on ESG disclosures and investigations indicate the US may follow that lead.

    b. **Financial materiality.** If ESG metrics are being positioned as a way to build long-term shareholder value, then the compensation program should focus on financially material ESG issues – e.g., by using the SASB materiality map to identify metrics.

c. **Supply Chain.** Will metrics include supplier performance or be limited to the company's own operations? If suppliers are in-scope, company executives will be judged on supplier performance monitoring and need to understand that the output of supplier audits will directly impact executive compensation. How will supplier performance be monitored/determined? Compensation committees must critically assess performance, reliability and validity of social audit programs and auditors – or be able to rely on the work of another board committee for those results.

d. **Ratings.** It's uncommon at this point to tie executive compensation to third-party output such as ESG ratings agencies, NGOs or social media attention/reaction. Companies can't directly alter actions of third parties, so messaging is critical for informing them about ESG performance. Tailor messages to intended audiences. ESG ratings agencies, for instance, may be put off by overly-generalized, lengthy but pretty reports. Other stakeholders are influenced by including even a single ESG slide in analyst presentations.

e. **Business Dynamics.** ESG commitments should reflect business dynamics. Future business plans may impact ESG performance and therefore, executive compensation. Some plans may inherently improve ESG standing, but other changes can negatively impact metric calculations or actual performance. For instance:

   i. M&A increases the number and complexity of operations, employees, locations and legal jurisdictions

   ii. External stakeholder influence can change dramatically as companies adapt to business transformations

   iii. Acquisitions, restarting mothballed operations and divestitures will impact mathematical results of ESG metrics calculations

   iv. Capital raising may require commitments to certain financial covenants or to particular groups of investors or lenders

f. **<u>Data Reliability.</u>** Ensure underlying data is reliable. Disclosure of most ESG data/metrics is not legally mandated, therefore companies typically do not have controls and QA/QC requirements on ESG data similar to those applied to financial information. Before committing to ESG compensation components, executives should assess the reliability and quality of the data on which they will rely. Steps to ensure data is reliable include:

   i. Involve internal audit and, if necessary, external subject experts to test the data quality and controls.

   ii. Test your compensation model rigorously – understand payouts and disclosures at various levels of achievement (or non-achievement). This includes understanding the impact of ESG metric achievements on financial and stock-based metrics and incentives.

   iii. Don't rely too heavily on certifications such as ISO14001. Companies expend much time and effort into obtaining certificates like these to hang on the wall. However, the value of the efforts may not be long-lasting as operational dynamics and external pressures change. ISO certifications may be better viewed as a snapshot in time, similar to other audits. "Trust but verify" is an appropriate philosophy.

2. **<u>Get internal buy-in.</u>** Managers and staff may be cynical of ESG metrics or performance improvements. They may not see an inherent ROI on the effort or expense. To counter organizational hesitancy, the board must clearly, concisely and <u>continuously</u> communicate the importance of the ESG strategy to executives, and executives must communicate to employees how to executive and accomplish those strategic goals. Reinforce expectations by cascading ESG metrics throughout the company and individual performance reviews.

3. **<u>Get external buy-in.</u>** Although tying ESG to executive compensation is becoming more common, investors are not monolithic in their desired timeframe for a return, and many remain skeptical of tying pay to anything other than financial results. Companies need to tell a consistent and persuasive ESG story in the CD&A and elsewhere. There's inconclusive data on the financial benefits of non-specific ESG metrics – but when ESG is well-planned and linked to a company's specific business case, it is possible to model that achieving strategic ESG metrics also improves company financial performance. Then, explain how the compensation program incentivizes those achievements.

Companies must also be realistic about what's achievable and be careful not to overpromise on results. If the metrics are positioned as a way to add shareholder value, keep in mind that it may take years for stock price to reflect ESG achievements.

4. **Annual operational metrics most common.** Currently, most US companies that include ESG metrics in incentive plans are using short-term operational metrics and tying them to the annual cash incentive plan. This doesn't mean that the metrics are only relevant to short-term performance. Rather, they are measured on a short-term basis, but form the building blocks of long-term sustainability and stakeholder metrics. These types of metrics are also attractive to companies and investors because they often can be easily communicated and linked to financial performance. Examples of operational metrics include:

    a. Amount of air emissions and water use

    b. Employee Engagement/Satisfaction

    c. Safety Statistics

    d. Turnover/Retention

    e. Talent Development

    f. Customer Satisfaction/Net Promoter Score

    g. Product Quality

5. **Hyper-long-term metrics aren't common.** Companies are announcing climate transition plans that call for reductions in emissions over the course of 20-30 years. So far, these reductions targets have not made their way into incentive plans – they would go well beyond the typical LTI timeframe of 3-5 years, which tends to be the outer limit for financial projections and

capital plans – and also the typical tenure of a CEO. Frameworks for "hyper-LTIs" suggest that rather than treating the time as a constant and the performance as a variable (what can be achieved in a 1- or 3-year period), a company would treat the performance as a constant (emissions reductions of a certain percent) and time would be the variable. In other words, executives would be rewarded for faster achievement of the goal. Companies that go this route would need to carefully vet the plan with stakeholders and proxy advisors, to avoid the appearance of an unearned "mega-grant."

6. **Stakeholders prefer "output" metrics.** "Output" metrics are objective and measurable results, such as an emissions reduction or number of diverse directors. Stakeholders tend to prefer these over "input" metrics that are focused on internal processes to achieve those results – such as implementing an internal carbon pricing mechanism or recruitment processes. If input metrics are used, they must be challenging and their link to strategic goals must be clearly disclosed.

7. **Determine payout structure.** There are many ways to incorporate ESG metrics into incentive plans. Here are a few approaches, some of which may be combined:

    a. **Discretionary or qualitative component.** Many companies designate the ESG component of the incentive plan as "discretionary" or "qualitative" rather than assigning formulaic weighting and payout criteria. Discretionary payouts have been particularly common for Diversity, Equity & Inclusion metrics, due to hesitation that disclosing a goal will be perceived as a "quota" that could attract criticism from many different angles, and due to an acknowledgement that employee population measurements may not capture the corporate culture aspects of inclusion. Measurement methods for DEI and other ESG metrics are expected to progress – so companies will need to evolve their programs as that happens.

        i. **Benefits of discretionary approach:**

            1. The program may be more palatable to executives, as achievement of new ESG metrics might seem daunting

2. Makes it easier to incorporate "impact-based" objectives, which are more difficult to measure – versus "operational" metrics, which are easier to measure but may be inadequate proxies for the underlying strategic goals

ii. **Drawbacks of discretionary approach:**

1. The path to earning the incentive – and achieving the strategic goal – is less clear to executives, possibly reducing the likelihood of achievement

2. Investors disfavor plans that have a discretionary component

3. Difficult for the proxy statement disclosure to provide the level of payout transparency that investors desire

b. **Formulaic weightings.** For operational metrics (KPIs), it may be possible to assign weightings that communicate the relative importance of each measure. Payouts may be based on threshold, target or maximum performance. The weighting of ESG metrics as a component of the overall incentive plan is typically less than 25%.

c. **Scorecards.** Many companies use a "scorecard" approach for multiple ESG metrics, which the compensation committee then evaluates holistically (i.e., the individual metrics aren't specifically weighted). This allows the company to select a number of ESG metrics.

d. **Downward modifier to financial performance metric.** Using ESG metrics as a downward modifier to a financial performance metric may be an attractive approach. It financially incentivizes performance, yields positive proxy disclosure if both the ESG and financial target are achieved, somewhat positive voluntary disclosure if the financial target isn't achieved but the ESG target is, and shows investors that there is not a full payout if the ESG target is not achieved. In addition, if neither the financial target nor the ESG target are achieved, it allows the company to avoid awkward disclosure about the missed ESG target.

e. **Individual performance metrics vs. company-wide metrics.** Individual performance ratings are useful because they can be tailored to specific roles and tied to quantitative or strategic objectives related to those roles. However, the company needs to explain in the CD&A and elsewhere how each of those individual metrics fit together to advance the company's overall strategy. Alternatively, company-wide goals can encourage collaboration among executives to achieve a common material goal, but will require more internal communications about the steps each person must take to achieve it.

8. **Ensure Board Compensation Committee members are knowledgeable on ESG matters, or at least those ESG components selected for compensation metrics**. As with other Board matters, ESG performance should be reviewed by members with reasonable subject matter expertise. At present, this is a major challenge for most companies. To fill this need, a cottage industry of ESG training/certifications has developed offering short (30 minutes to 4 hour) sessions. Such trainings should be considered a starting point for developing Board competency on ESG, not the terminus. Claims of greenwashing and exaggerating Board competency based on such trainings have risen dramatically in the past twelve months. A new term – "greenwishing" - has entered the lexicon to describe unrealistic or aspirational corporate ESG performance commitments, or those not backed up by Board and executive subject matter knowledge.

9. **Don't forget your risk factors.** ESG risk and materiality determinations were historically less robust than other, more traditional, risk factors. However, the nature of materiality has evolved. When identifying and assessing executive ESG performance metrics, ESG matters may warrant consideration as material risk factors. If this occurs, don't forget to update your company's risk disclosure in the next Form 10-K or Form 10-Q.

10. **Be prepared to take action and make hard decisions**. New supplier and corporate performance mandates take time to percolate through any corporate ecosystem. Part of implementation will be facing negative developments and making difficult decisions to improve ESG performance in line with compensation packages. Executives must be prepared to be fully transparent, terminate supplier relationships, make unpleasant

personnel changes, and carry out decisions that do not conflict with ESG performance expectations even where persuasive business cases exist. Companies who are themselves suppliers must be ready to implement new customer demands concerning ESG performance, or face losing business. There may be a rocky transition period - leadership must be fully committed to weather the storm.

← Non-Competes: Employee Questions About the FTC's Ban | Main | IPOs: Compensation-Related Action Items →

May 13, 2024

Proxy Perks Disclosures: SEC Enforcement Still On the Beat

Executive personal jet use is back in the news. The WSJ recently reported on the difference between the value of personal jet use reported in companies' proxy statements versus the actual cost to the companies:

> Under federal securities rules, companies must report as compensation the "aggregate incremental cost" of perquisites such as free personal flights. Most say they count expenses directly tied to a specific trip, including fuel, landing fees, airport taxes, catering, crew lodging and meals, and an hourly rate for maintenance, plus the cost of repositioning empty aircraft for later use, securities filings show. […]
>
> Typically left out: fixed costs that don't change by flying more, including pilot salaries, insurance and the cost of acquiring the aircraft. Companies say they would pay these costs anyway, because the aircraft are primarily used for business. Charter companies charge customers thousands of dollars an hour to fly on similar jets, fees set to cover both the incremental costs reported by the executives' employers as well as fixed costs—and a margin for profit. The result: a gulf between what executives save by taking personal flights in the company jet and what companies report spending on the trips.

In the meantime, this Morgan Lewis blog post highlights that the SEC continues to focus on perks disclosure—in particular, executive use of corporate jets. In enforcement actions from 2020 to 2023, the violations stemmed from the issues below. Keep these in mind as you consider whether and how to improve your controls:

> – Improper internal disclosure and financial reporting controls
> – Executives' failure to provide the necessary information (most commonly in response to directors and officers insurance (D&O) questionnaires) to enable companies to identify and properly disclose perquisites
> – Lack of an adequate company process to determine whether executive flights were perquisites that should be disclosed
> – Failure to appropriately train employees in the roles responsible for making the determination of whether items were perquisites
> – Lack of a formal company policy regarding approval and use of noncommercial aircraft and aviation expense reimbursement, including one case where the lack of a formal reimbursement policy resulted in the CEO being responsible for approving his own expenses

For more resources, also check out the Perks & Other Personal Benefits Chapter of the "Executive Compensation Disclosure Treatise." We also have two podcasts on this complicated issue featuring Brad Goldberg of Cooley and Stewart Lapayowker of Lapayowker Jet Counsel.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2024/05/proxy-perks-disclosures-sec-enforcement-still-on-the-beat.html

← The Eligible Sell-to-Cover Exception in Rule 10b5-1: The Staff Provides Some Guidance | Main |
Director Pay Limits: Current Levels for the S&P 500 →

February 28, 2024

Trending Executive Compensation Shareholder Proposals

In our recent webcast — "The Latest: Your Upcoming Proxy Disclosures" — Ron Mueller discussed this year's hot topics for compensation-related shareholder proposals. As we've discussed, we saw many proposals seeking shareholder approval of severance agreements last year. Ron noted in his commentary that this proposal is still common.

Ron also discussed three proposals that are new this year. Here's an excerpt from the webcast:

> One is requesting that companies amend their clawback policies […] the supporting statement alludes to the fact that if one executive engages in misconduct and, as a result, payouts are higher than they should have been, then other executives should also be forfeiting their compensation regardless of whether those executives themselves engaged in misconduct.
>
> From the conservative side, there were some proposals out there asking companies to eliminate greenhouse gas reduction metrics as performance measures. More and more companies are including environmental metrics as part of their bonus programs, as one of their performance metrics. Here's a proposal saying, "No, stop doing that." It'll be interesting to see what kind of traction that gets.
>
> Lastly, another new proposal is asking for an annual Say-on-Pay vote on director compensation. As if that's not novel enough, the two twists on that are that it has to be an advance vote before the directors get paid, not after the fact vote like Say-on-Pay for executives, and the proposal is in the form of a binding bylaw amendment. If it was approved by shareholders, it would go into effect automatically under most corporate law programs and most bylaws.

Ron also noted that it's not always clear what exactly the proposals are asking for. And, in some cases, companies are increasing their engagement with proponents — especially since institutional shareholders are asking companies what each proposal is asking for, what the company is currently doing on that front and whether it met with the proponent and tried to negotiate out the proposal.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2024/02/trending-executive-compensation-shareholder-proposals.html

← The Pay & Proxy Podcast: T+1 Settlement & Equity Award Tax Withholding | Main | Say-on-Pay: Things Are Looking Up! →

April 30, 2024

Say-on-Director-Pay: "Double Binding" Bylaw Proposals on the Ballot

We've blogged about the concept of "say-on-director-pay" from time to time around here. Most recently as part of the director compensation settlement at Tesla. That settlement led to a new development this season: a shareholder proposal at 13 companies for "Double Binding Director Say-on-Pay."

The proposal is unique because it's structured as a binding bylaw amendment (rather than a precatory request). This framing seems to be more popular this year – I blogged a few weeks ago on our Proxy Season Blog on TheCorporateCounsel.net about an "independent chair" proposal that was also submitted as a binding resolution. The bylaw provision would say:

> **Compensation.** The compensation of directors the corporation pays shall be fixed at $1 in a f iscal year; provided, however, the corporation may pay, grant, or award compensation greater than $1 in a fiscal year if such compensation has been (1) disclosed to stockholders in advance of the fiscal year in which the corporation will pay, grant, or award such compensation; (2) submitted to an approval vote of stockholders at an annual or special meeting of stockholders in advance of the fiscal year in which the corporation will pay, grant, or award such disclosed compensation; and (3) approved by a majority of stockholder votes present in person or represented by proxies and entitled to vote cast in favor of the disclosed annual compensation at an annual or special meeting of stockholders in advance of the fiscal year in which the corporation will pay, grant, or award such compensation. In the fiscal year in which this Section [] takes effect, the Board shall continue to pay, grant, or award any such compensation that the Board has previously approved for such fiscal year.

If this proposal is approved, it means that director pay would be subject to an annual, binding vote. Directors could consider whether they would be excluded from participating in this vote. If you want more detail on this proposal (submitted by Michael Levin at The Activist Investor), check out the "Proxy Preview" report that I flagged last month. Michael recently shared this update about how the proposals are faring. Here are key points:

> 1. Going to a vote at 5 companies (NiSource on May 13th, PayPal on May 22nd, Fortiv, Alphabet, and Devon Energy)
>
> 2. Excluded with no-action relief at 6 companies, based on the argument that excluding directors from the vote would violate state law (Michael says "he won't make that mistake again")
>
> 3. 2 companies still in process

It will be interesting to see the voting results. Michael implies that there will be more proposals to come…

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2024/04/say-on-director-pay-double-binding-bylaw-proposals-on-the-ballot.html

July 25, 2023

SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2023 PROXY SEASON

To Our Clients and Friends:

This client alert provides an overview of shareholder proposals submitted to public companies during the 2023 proxy season,[1] including statistics and notable decisions from the staff (the "Staff") of the Securities and Exchange Commission (the "SEC") on no-action requests.[2]

I. SUMMARY OF TOP SHAREHOLDER PROPOSAL TAKEAWAYS FROM THE 2023 PROXY SEASON

As discussed in further detail below, based on the results of the 2023 proxy season, there are several key takeaways to consider for the coming year:

- ***Shareholder proposal submissions rose yet again.*** For the third year in a row, the number of proposals submitted increased. In 2023, the number of proposals increased by 2% to 889—the highest number of shareholder proposal submissions since 2016.

- ***The number of executive compensation proposals significantly increased, along with a continued increase in environmental and social proposals.*** Executive compensation proposals increased notably, up 108% from 2022, with the increase largely attributable to proposals seeking shareholder approval of certain executive severance agreements. The number of both environmental and social proposals also increased, up 11% and 3%

[1] **Data on No-Action Requests:** For purposes of reporting statistics regarding no-action requests, references to the 2023 proxy season refer to the period between October 1, 2022 and June 1, 2023. Data regarding no-action letter requests and responses was derived from the information available on the SEC's website.

Data on Shareholder Proposals: Unless otherwise noted, all data on shareholder proposals submitted, withdrawn, and voted on (including proponent data) is derived from Institutional Shareholder Services ("ISS") publications and the ISS shareholder proposals and voting analytics databases, with only limited additional research and supplementation from additional sources, and generally includes proposals submitted and reported in these databases for the calendar year from January 1 through June 1, 2023, for annual meetings of shareholders at Russell 3000 companies held on or before June 1, 2023. Consistent with last year, the data for proposals withdrawn and voted on includes information reported in these databases for annual meetings of shareholders held through June 1, 2023. References in this alert to proposals "submitted" include shareholder proposals publicly disclosed or evidenced as having been delivered to a company, including those that have been voted on, excluded pursuant to a no-action request, or reported as having been withdrawn by the proponent, and do not include proposals that may have been delivered to a company and subsequently withdrawn without any public disclosure. All shareholder proposal data should be considered approximate. Voting results are reported on a votes-cast basis calculated under Rule 14a-8 (votes for or against) and without regard to whether the company's voting standards take into account the impact of abstentions.

Where statistics are provided for 2022, the data is for a comparable period in 2022.

[2] Gibson, Dunn & Crutcher LLP assisted companies in submitting the shareholder proposal no-action requests discussed in this alert that are marked with an asterisk (*).

respectively, compared to 2022 and 68% and 24% respectively, compared to 2021. In contrast, governance proposals declined 14%, and civic engagement proposals declined 6%. The five most popular proposal topics in 2023, representing 43% of all shareholder proposal submissions, were (i) climate change, (ii) independent chair, (iii) nondiscrimination and diversity-related, (iv) shareholder approval of certain severance agreements, and (v) special meetings. Of the five most popular topics in 2023, all but one (shareholder approval of certain severance agreements replacing lobbying spending and political contributions) were also in the top five in 2022.

- ***While the number of no-action requests dropped significantly, the percentage of proposals excluded pursuant to a no-action request rebounded from 2022's historic low.*** Only 175 no-action requests were submitted to the Staff in 2023, representing a submission rate of 20%, down from a submission rate of 29% in 2022 and 34% in 2021. The overall success rate for no-action requests, after plummeting to only 38% in 2022, rebounded to 58% in 2023, but was still well below the 71% success rate in 2021, and marked the second lowest success rate since 2012. Success rates in 2023 improved for duplicate proposals (100% in 2023, up from 31% in 2022), procedural (80% in 2023, up from 68% in 2022), ordinary business (50% in 2023, up from 26% in 2022), and substantial implementation grounds (26% in 2023, up from with 15% in 2022), while success rates declined for resubmissions (43% in 2023, compared with 56% in 2022) and violation of law (33% in 2023, compared with 40% in 2022).

- ***The number of proposals voted on increased yet again, but overall voting support decreased significantly, and less than 3% of proposals submitted received majority support.*** In 2023, over 54% of all proposals submitted were voted on, compared with 50% of submitted proposals voted on in 2022. Despite this increase, average support for all shareholder proposals plummeted to 23.3% in 2023, down from 30.4% in 2022. The decrease in average support was primarily driven by decreased support for both social and environmental proposals, with support for social (non-environmental) proposals decreasing to 17.2% in 2023 from 23.2% in 2022 and support for environmental proposals decreasing to 21.3% in 2023 from 33.8% in 2022. And in line with lower support overall, only 25 shareholder proposals received majority support in 2023, down from 55 in 2022.

- ***More change is in store for the shareholder proposal process, as the SEC considers further amendments to Rule 14a-8, Congress homes in on reform of Rule 14a-8, and stakeholders challenge the SEC's role in the process.*** In July 2022, the SEC proposed amendments to Rule 14a-8 that, if adopted, would make it significantly more challenging for companies to exclude shareholder proposals on substantial implementation, duplication, and resubmission grounds. The SEC targeted approval of these amendments by October 2023, which means the 2024 proxy season could see further changes in how companies approach no-action requests. Additionally, the Financial Services Committee of the U.S. House of Representatives recently formed a Republican ESG Working Group, which has identified reforming the Rule 14a-8 no-action request process as a key priority of the Working Group's focus on reforming the proxy voting system for retail investors. And, as discussed below, legal action by two stakeholder groups, the National Center for Public Policy Research and the National Association of Manufacturers, could disrupt the shareholder proposal process altogether.

- ***Proponents' use of exempt solicitations grows again, and now others are joining the game.*** Exempt solicitation filings continued to proliferate, with the number of filings reaching a record high again this year and increasing almost 22% over last year and 64% compared to 2021. As in prior years, the vast majority of exempt solicitations filed in 2023 were filed by shareholder proponents on a voluntary basis—*i.e.*, outside of the intended scope of the SEC's rules—in order to draw attention and publicity to pending shareholder proposals. Interestingly, third parties have begun intervening in the shareholder proposal process by using exempt solicitation filings to provide their views on shareholder proposals submitted by unaffiliated shareholder proponents.

II. OVERVIEW OF SHAREHOLDER PROPOSAL OUTCOMES

A. Overview of Shareholder Proposals Submitted

According to the available data, shareholders submitted 889 shareholder proposals during the 2023 proxy season, up 2% from 868 in 2022—marking the third consecutive year of increased submissions and the highest number of shareholder proposal submissions since 2016. The table below shows key year-over-year submission trends across five broad categories[3] of shareholder proposals in 2023—governance, social, environmental, civic engagement, and executive compensation. As in 2022, social and environmental proposals combined represented over 50% of all proposals submitted (55% in 2023, up from 53% in 2022), with social proposals representing 33% of all proposals submitted. This was followed by governance proposals (24%),

[3] In recent years, as shareholder proposals increasingly touch on multiple topics that may overlap, the categorization of the specific subject matter of shareholder proposals has become increasingly challenging. Where a shareholder proposal addresses multiple topics, we have categorized the proposal based on what appears to be primary focus of the proposal. We categorize shareholder proposals based on subject matter as follows:

Governance proposals include proposals addressing: (i) independent board chairman; (ii) shareholder special meeting rights; (iii) proxy access; (iv) majority voting for director elections; (v) board declassification; (vi) shareholder written consent; (vii) elimination/reduction of supermajority voting; (viii) director term limits; (ix) stock ownership guidelines; and (x) shareholder approval of bylaw amendments.

Social proposals cover a wide range of issues and include proposals relating to: (i) discrimination and other diversity-related issues (including board diversity and racial equity audits); (ii) employment, employee compensation or workplace issues (including gender/ethnicity pay gap); (iii) board committees on social and environmental issues; (iv) social and environmental qualifications for director nominees; (v) disclosure of board matrices including director nominees' ideological perspectives; (vi) societal concerns, such as human rights, animal welfare, and reproductive health; and (vii) employment or workplace policies, including the use of concealment clauses, mandatory arbitration, and other employment-related contractual obligations.

Environmental proposals include proposals addressing: (i) climate change (including climate change reporting, climate lobbying, greenhouse gas emissions goals, and climate change risks); (ii) climate transition planning; (iii) plastics, recycling, or sustainable packaging; (iv) renewable energy; (v) environmental impact reports; and (vi) sustainability reporting.

Civic engagement proposals include proposals addressing: (i) political contributions disclosure; (ii) lobbying policies and practices disclosure; and (iii) charitable contributions disclosure.

Executive compensation proposals include proposals addressing: (i) severance and change of control payments; (ii) performance metrics, including the incorporation of sustainability-related goals; (iii) compensation clawback policies; (iv) equity award vesting; (v) executive compensation disclosure; (vi) limitations on executive compensation; and (vii) CEO compensation determinations.

environmental proposals (21%), civic engagement proposals (11%), executive compensation proposals (8%), and other proposals (2%).

Overview of Shareholder Proposals Submitted

Proposal Category	2023	2022	2023 vs 2022[4]	Observations
Social	297	287	↑3%	The largest subcategory, representing 25% of all social proposals, continued to be nondiscrimination and diversity-related proposals, with 76 submitted in 2023 (though down from 97 submitted in 2022 and 128 in 2021). Of note, 22 proposals related to reproductive healthcare were submitted in 2023, up from only four such proposals submitted in 2022.
Governance	212	246	↓14%	Independent board chair proposals were the most common governance proposal, representing 40% of all governance proposals with 85 submitted (up from 20% in 2022). Proposals related to shareholder special meeting rights represented 20% of governance proposals (down from 46% in 2022).
Environmental	188	169	↑11%	The largest subcategory, representing 80% of these proposals, continued to be climate change proposals, with 150 submitted in 2023 (increasing from 129 in 2022 and 83 in 2021). Of note, there were 37 climate change proposals submitted in 2023 that specifically addressed issues related to climate transition planning.
Civic engagement	97	103	↓6%	Lobbying spending proposals decreased to 34 in 2023 from 45 in 2022, and political contribution proposals decreased to 30 in 2023 from 45 in 2022. New types of civic engagement proposals this season included 12 proposals from an ESG-skeptic perspective focused on the company's political speech or affiliations with certain entities.
Executive compensation	75	36	↑108%	The largest subcategory of executive compensation proposals continued to be those requesting boards seek shareholder approval of certain severance agreements, representing 63% of these proposals, up from 44% in 2022. There were seven proposals requesting that companies include, or report on the possibility of including, social- or environmental-focused performance measures in executive compensation programs (such as greenhouse gas ("GHG") emissions and maternal morbidity) up from just two such proposals submitted in 2022 (but down from 15 proposals submitted in 2021).

[4] Data in this column refers to the percentage increase or decrease in shareholder proposals submitted in 2023 as compared to the number of such proposals submitted in 2022.

The table below shows that four of the five most common proposal topics during the 2023 proxy season were the same as those in the 2022 proxy season, with proposals requesting boards seek shareholder approval of certain severance agreements joining the top five in 2023 and lobbying spending and political contributions proposals leaving the top five. A significant decrease in the number of special meeting proposals drove down the concentration of the top five proposal topics, which collectively represented 45% of all shareholder proposals submitted in 2023, down from 49% in 2022.

Top Shareholder Proposals Submitted to Public Companies

2023	2022
Climate change (17%)	Climate change (15%)
Independent chair (10%)	Special meetings (13%)
Nondiscrimination & diversity (9%)	Nondiscrimination & diversity (11%)
Shareholder approval of severance agreements (5%)	Independent chair (5%)
Special meetings (5%)	Lobbying spending (5%) Political contributions (5%)

B. Overview of Shareholder Proposal Outcomes

As shown in the table below, the 2023 proxy season saw both new and continued trends in proposal outcomes that emerged in the 2022 proxy season: (i) the percentage of proposals voted on increased moderately from 2022 (54% in 2023 compared to 50% in 2022), but overall support declined by over seven percentage points (23.3% in 2023 compared to 30.4% in 2022); (ii) the percentage of proposals excluded through a no-action request increased slightly in 2023 (9% in 2023 compared to 8% in 2022); and (iii) the percentage of proposals withdrawn decreased significantly to 16% in 2023 compared to 26% in 2022.

Social and environmental proposals both continued to see decreased withdrawal rates in 2023, with 20% of social proposals withdrawn (compared to 30% in 2022) and 32% of environmental proposals withdrawn (compared to 51% in 2022). These significant drops in withdrawal rates may reflect, among other factors, the impact of Staff Legal Bulletin No. 14L (Nov. 3, 2021) ("SLB 14L") on the viability of no-action requests in 2022, leading shareholders to demand more robust commitments from companies in exchange for withdrawal. The percentage of withdrawn governance proposals (4%) dropped (down from 9% in 2022, but almost level with 5% in 2021), reflecting the fact that certain individuals, who are the main proponents of many governance proposals, generally are disinclined to withdraw their proposals, even when a company has substantially implemented the request.

Shareholder Proposal Outcomes[5]	2023[6]	2022[7]
Total number of proposals submitted	889	868
Excluded pursuant to a no-action request	9% (82)	8% (71)
Withdrawn by the proponent	16% (143)	26% (224)
Voted on	54% (483)	50% (438)

Voting results. Shareholder proposals voted on during the 2023 proxy season averaged support of 23.3%, down significantly from 30.4% in 2022. Notably, looking at just environmental proposals, average support decreased significantly to 21.3%, compared to 33.3% support in 2022. Consistent with the trend we saw in 2022 and as discussed below, the lower support for climate change proposals appears to be driven by an increase in more prescriptive proposals which have received lower support from institutional investors. Similarly, support for social (non-environmental) proposals decreased to 17.2% in 2023 from 23.2% in 2022, likely for the same reason. Average support for governance proposals decreased to 31.1% from 36.7% in 2022. Of particular note, 62 of the 483 proposals that were voted on during the 2023 proxy season received less than 5% shareholder support, the lowest resubmission threshold under Rule 14a-8(i)(12)—up from 47 proposals that received less than 5% support in 2022 and consistent with the overall decline in shareholder support.

Four of the top five shareholder proposals by average shareholder support in 2023 were different from those reported in 2022. As in prior years, corporate governance proposals received generally high levels of support. The table below shows the five shareholder proposal topics voted on at least three times that received the highest average support in 2023.

Top Five Shareholder Proposals by Voting Results[8]

Proposal	2023	2022[9]
Simple majority vote (eliminate supermajority voting)	57.9% (13)	84.1% (6)
Report on climate lobbying	38.2% (8)	N/A
Freedom of association	36.4% (6)	N/A
Majority voting for director elections	35.7% (3)	N/A
Workplace health and safety audit	34.0% (4)	N/A

5 Excludes proposals that, for other reasons, were reported in the ISS database as having been submitted but that were not in the proxy or were not voted on, including, for example, due to a proposal being withdrawn but not publicized as such or the failure of the proponent to present the proposal at the meeting. As a result, in each year, percentages may not add up to 100%.

6 As of June 1, 2023, ISS reported that 118 proposals (representing 13% of the proposals submitted during the 2023 proxy season) remained pending.

7 As of June 1, 2022, ISS reported that 108 proposals (representing 12% of the proposals submitted during the 2022 proxy season) remained pending.

8 The numbers in the parentheticals indicate the number of times these proposals were voted on.

9 In 2022, the five shareholder proposals voted on at least three times that received the highest average support included board declassification, eliminate/reduce supermajority voting, submit severance agreement to shareholder vote, report on civil rights/racial equity audit, and majority voting for director elections.

Majority-supported proposals. As of June 1, 2023, only 25 proposals (less than 3% of the 889 proposals submitted) received majority support, as compared with 55 proposals (or 6% of the 868 proposals submitted in 2022) that had received majority support as of June 1, 2022. Notably, after several consecutive years of growth in the number of majority-supported climate change proposals, only two climate change proposals received majority support in 2023, including one proposal that the company supported. This is in contrast to nine majority-supported climate change proposals in each of 2022 and 2021, and four in 2020. Despite the sharp decline in majority-supported proposals in 2023, there were a few noteworthy proposals that received majority support, including a proposal requesting the commission of a third-party assessment of the company's commitment to freedom of association and collective bargaining rights[10] and two human capital management proposals—the first requesting a report on the effectiveness of the company's diversity, equity and inclusion ("DEI") efforts and metrics[11] and the second requesting a report on the company's efforts to prevent workplace harassment and discrimination.[12]

Governance proposals accounted for 64% of proposals that received majority support in 2023 (compared with 38% in 2022). While governance proposals have consistently ranked among the highest number of majority-supported proposals, the steep decline in the number of climate-related shareholder proposals receiving majority support resulted in a much narrower range of majority-supported proposals than in recent years. Environmental and social proposals together represented 24% of majority-supported proposals, while 8% of majority-supported proposals related to executive compensation, each of which related to requesting that boards seek shareholder approval of certain severance agreements. As of June 1, 2023, only one civic engagement proposal received majority support. The table below shows the proposals that received majority support.

Proposals that Received Majority Support

Proposal	2023	2022[13]
Simple majority vote (eliminate supermajority voting)	8	6
Shareholder special meeting rights	5	9
Climate change	2	9
Shareholder approval of severance agreements	2	4
Majority voting in director elections	1	2
Lobbying spending	1	2
Permit shareholder action by written consent	1	1
Workplace health and safety audit	1	0
Majority of votes cast to remove directors	1	0
Report on effectiveness of DEI efforts and metrics	1	0
Report on prevention of workplace harassment and discrimination	1	0
Third-party report on freedom of association and collective bargaining rights	1	0

10 *See* Starbucks Corporation's proxy statement at 81, *available here*.

11 *See* Expeditors International of Washington, Inc's proxy statement at 40, *available here*.

12 *See* Wells Fargo & Company's proxy statement at 115, *available here*.

13 Indicates the number of similar proposals that received majority support in 2022.

III. SHAREHOLDER PROPOSAL NO-ACTION REQUESTS

A. *Overview of No-Action Requests*

Submission and withdrawal rates. The number of shareholder proposals challenged in no-action requests submitted to the Staff during the 2023 proxy season again decreased significantly, down 28% compared to 2022 and down 35% compared to 2021, likely reflecting lower success rates in 2022.[14]

No-Action Request Statistics

	2023	**2022**	**2021**
No-action requests submitted	175	244	272
Submission rate[15]	20%	29%	34%
No-action requests withdrawn	33 (19%)	56 (23%)	64 (24%)
Pending no-action requests (as of June 1)	0	3	4
Staff Responses[16]	142	185	204
Exclusions granted	82 (58%)	71 (38%)	144 (71%)
Exclusions denied	60 (42%)	114 (62%)	60 (29%)

Most common arguments. The below table, reflecting the number of no-action requests that contained each type of argument, reveals a change in the most-argued grounds for exclusion from ordinary business in 2022 to procedural in 2023. As in recent years, ordinary business and substantial implementation continued to be the most argued substantive grounds for exclusion.

Most Common Arguments for Exclusion

	2023	**2022**	**2021**
Procedural	71 (41%)	64 (26%)	86 (32%)
Ordinary Business	68 (39%)	106 (43%)	96 (35%)
Substantial Implementation	38 (22%)	91 (37%)	114 (42%)
False/Misleading	17 (10%)	42 (17%)	38 (14%)

Success rates. This year, the Staff granted approximately 58% of no-action requests, a significant increase over the 38% success rate in 2022, though still significantly below the 71% success rate in 2021 and the 70% success rate in 2020. Consistent with 2022, the Staff most often granted no-action requests based on procedural (representing 48% of successful requests), ordinary business (representing 34% of successful requests), and substantial implementation (representing 9% of successful requests) grounds. Notably, no-action requests based on these three grounds together accounted for over 90% of successful requests in 2023 compared to 77%

[14] Gibson Dunn remains a market leader for handling shareholder proposals and no-action requests during proxy season, having filed approximately 20% of all shareholder proposal no-action requests each proxy season for several years.

[15] Submission rates are calculated by dividing the number of no-action requests submitted to the Staff by the total number of proposals reported to have been submitted to companies.

[16] Percentages of exclusions granted and denied are calculated by dividing the number of exclusions granted and the number denied, each by the number of Staff responses.

of successful requests in 2022, evidencing a narrower concentration of the grounds on which successful requests were granted. While the success rate for substantial implementation arguments for environmental proposals increased to 20% (up from 6% in 2022), only one such request was actually successful,[17] and the increase is instead attributable to there being a smaller number of total requests for exclusion on substantial implementation grounds. No social proposals were successfully excluded on substantial implementation grounds, a continuation of the downward trend noted in 2022, where 3% of social proposals were successfully excluded on substantial implementation grounds. Meanwhile, the high success rate for proposals seeking exclusion on duplicate proposal grounds was driven by the overall decrease in no-action requests seeking exclusion on this basis—in 2023 only eight no-action requests sought exclusion on duplicate proposal grounds,[18] down from 23 in 2022.

Success Rates by Exclusion Ground[19]

	2023	2022	2021
Duplicate proposals	100%	31%	38%
Procedural	80%	68%	84%
Ordinary business	50%	26%	65%
Resubmissions	43%	56%	100%
Violation of law	33%	40%	50%
Substantial implementation	26%	15%	67%

Top proposals challenged. This year, the most common proposals for which companies submitted no-action requests (on both procedural and substantive grounds) were those requesting a policy requiring an independent board chair, amendments to the company's governing documents to expand and/or lower the threshold for special meetings, a policy requiring the board to seek shareholder approval of certain executive severance arrangements, and audits related to racial equity or civil rights issues.

The no-action requests related to independent board chair proposals made the following arguments: procedural (7), duplicate proposal (2), vague or false/misleading (1), substantial implementation (1), and resubmission (1). The successful requests were granted on the following grounds: procedural (4), duplicate proposal (2), substantial implementation (1), and resubmission (1).

The no-action requests related to special meeting proposals made the following arguments: procedural (6), vague or false/misleading (3), violation of law (2), absence of power/authority (1), and substantial implementation (1). Two of the successful requests were granted on procedural grounds, and one was granted on substantial implementation grounds. The no-action requests related to shareholder approval of certain executive severance agreements made the

17 *Alliant Energy Corp.* (avail. Mar. 30, 2023).

18 Of the eight no-action requests that sought exclusion on duplicate proposal grounds, four no-action requests were granted on the basis of duplicate proposals, one no-action request was withdrawn and three no-action requests were granted on alternative grounds without the Staff issuing a decision on the duplicate proposal argument.

19 Success rates are calculated by dividing the number of no-action requests granted on a particular ground by the total number of no-action requests granted or denied on that ground, excluding no-action requests that are withdrawn or granted on an alternative ground.

following arguments: procedural (8), ordinary business (1), and substantial implementation (1). Seven of the successful requests were granted on procedural grounds, and one was granted on ordinary business grounds. The no-action requests related to racial equity and civil rights audits made the following arguments: procedural (6), resubmission (2), and substantial implementation (1). The two successful requests were both granted on procedural grounds.

	Submitted	Denied	Granted	Withdrawn
Independent board chair	11	2 (18%)	8 (73%)	1 (9%)
Special meeting right/threshold	10	5 (50%)	3 (30%)	2 (20%)
Shareholder approval of certain executive severance agreements	10	2 (20%)	8 (80%)	N/A
Racial equity/civil rights audit	9	4 (44%)	2 (22%)	3 (33%)

B. Key No-Action Request Developments

There were a number of noteworthy procedural and substantive developments in no-action decisions this year.

1. Success Rates Rose, but Submissions Declined

This season saw a rebound in the success rates of no-action requests, with the Staff granting relief to approximately 58% of no-action requests, a significant increase over the 38% success rate in 2022, but still well below the 71% success rate in 2021. This rise in success rates can be attributed in part to a decline in overall no-action requests submitted (175 in 2023, compared to 244 in 2022), with companies being more reluctant to challenge proposals given last year's low success rate. This decrease in submissions was driven in part by a marked decrease in submission of no-action requests related to environmental (21 in 2023, compared to 38 in 2022) and social (61 in 2023, compared to 92 in 2022) proposals.

The overall decline in submissions was also driven in part by companies declining to submit no-action requests arguing for exclusion on substantive bases that appear to be increasingly disfavored by the Staff. For example, during this season no proposals were successfully excluded under three key substantive bases—Rule 14a-8(i)(1), which permits the exclusion of proposals that are improper under state law; Rule 14a-8(i)(3), which permits exclusion if the proposal or supporting statement is false or misleading or otherwise in violation of proxy roles; and Rule 14a-8(i)(6), which permits the exclusion of proposals where the company would lack the power or authority to implement the proposal. Similarly, there were only three no-action requests submitted this season that argued for exclusion under the economic relevance exclusion in Rule 14a-8(i)(5) and none were successful. The Staff under Chair Clayton sought to revitalize the economic relevance exclusion in 2017 through the issuance of Staff Legal Bulletin No. 14I (Nov. 1, 2017), but that guidance was subsequently rescinded by SLB 14L. Finally, the number of no-action requests arguing for exclusion on the basis of substantial implementation under Rule 14a-8(i)(10) dropped dramatically in 2023 (only 38 in 2023, compared to 91 in 2022). While the success rate for substantial implementation rebounded modestly from 2022 (26% in 2023, compared to 15% in 2022), it continued to be well below recent years.

2. Continued Implications of SLB 14L on No-Action Requests

As discussed in our 2022 client alert,[20] in November 2021, the Staff issued SLB 14L,[21] which rescinded certain Staff guidance and reversed prior no-action decisions, upending the Staff's recent approach to the application of the economic relevance exclusion in Rule 14a-8(i)(5) and the ordinary business and micromanagement exclusions in Rule 14a-8(i)(7). SLB 14L rejected a more recent company-specific approach to significance and expressed the Staff's current view that the analytical focus should be on whether the proposal raises issues with a broad societal impact such that they transcend the company's ordinary business and whether the proposal raises issues of broad social or ethical concern when interpreting economic relevance. Moreover, SLB 14L rejected the Staff's long-standing position requiring a sufficient nexus between a proposal and the social concern raised in the proposal.[22] SLB 14L also changed the Staff's approach on assessing micromanagement, focusing on the granularity sought by a proposal and the extent to which a proposal limits company or board discretion rather than the prior focus on whether a proposal included requests for specific detail, timeframes, or targets.

The position taken by the Staff in SLB 14L appears to have led to an overall decline during the 2022 and 2023 seasons in the number of no-action requests arguing ordinary business grounds under Rule 14a-8(i)(5) and Rule 14a-8(i)(7). For the second year in a row, no proposals were excluded during the 2023 season under Rule 14a-8(i)(5). The 2023 season saw a continued decline in the number of no-action requests arguing ordinary business grounds under Rule 14a-8(i)(7), likely due to SLB 14L. In total, 58 no-action requests, or 6.5% of all proposals, challenged proposals on ordinary business grounds in 2023 (excluding those making only a micromanagement argument), with a success rate of 45%. By comparison, 95 no-action requests, or 11% of all proposals, challenged proposals on ordinary business grounds in 2022 (excluding those making only a micromanagement argument), with a success rate of 26%, and 87 no-action requests challenged proposals on ordinary business grounds in 2021, with a success rate of 64%. This drastic change in success rates for ordinary business arguments between 2021 and 2022 was likely the result of the Staff's abandonment of the traditional company-specific approach to significance. Instead, under SLB 14L, the Staff is focused on whether a proposal raises issues with a broad societal impact, without regard to any connection between those issues and a company's business operations. Moreover, the Staff has demonstrated increased willingness to recognize more topics as transcending ordinary business.

The number of shareholder proposals excluded on ordinary business grounds rebounded from the historically low success rate in 2022. Notably, the increase in success rates appears to be attributable in part to the fact that some proponents, apparently emboldened by their success in 2022 and the Staff's unwillingness to grant exclusion on the grounds of ordinary business, submitted proposals that addressed matters that have traditionally been viewed as clearly relating to ordinary business. It remains to be seen whether the Staff has recalibrated its evaluation of ordinary business arguments and whether proponents will return to submitting only those types

[20] *Available here.*

[21] *Available here.*

[22] *See* SLB 14H (Oct. 22, 2015) at n.32 ("Whether the significant policy exception applies depends, in part, on the connection between the significant policy issue and the company's business operations.") *citing* SLB 14E (Oct. 27, 2009) (stating that a proposal generally will not be excludable "as long as a sufficient nexus exists between the nature of the proposal and the company")).

of proposals that the Staff has refused to exclude since SLB 14L.

3. Resurrection of Micromanagement

SLB 14L impacted the Staff's approach on assessing micromanagement during the 2022 season: companies submitted 45 no-action requests arguing for exclusion on micromanagement grounds, and the Staff only granted two of those requests on that basis, representing a success rate of 8%. In contrast, the 2023 season saw a significant increase in the success of no-action requests on micromanagement grounds, with companies submitting 41 no-action requests arguing for exclusion on micromanagement grounds as at least one basis for exclusion, and the Staff granting eight of those requests on that basis, representing a success rate of 31%.[23] The rise in the success rate of micromanagement arguments is partially attributable to the fact that proponents are increasingly drafting more prescriptive proposals. Successfully excluded proposals spanned different categories of proposals, including those related to GHG emissions and climate change, death benefits for senior executives, corporate charitable contributions and pilot participation in a program to mitigate risks of forced labor in a company's supply chain.

4. Effects of 14a-8 Amendments on No-Action Requests

As discussed in our 2022 client alert, in September 2020, the SEC adopted amendments (the "Amended Rules") to key aspects of the SEC's shareholder proposal rule. The 2023 proxy season was only the second season following the application of the Amended Rules.

Among other changes, the Amended Rules increased the resubmission thresholds in Rule 14a-8(i)(12), which permits exclusion of a proposal if a similar proposal was last included in the proxy materials within the preceding three years and if the last time it was included it received: less than 5% support, if proposed once within the last five years (increased from 3%); less than 15% support, if proposed twice within the last five years (increased from 6%); or less than 25% support, if proposed three or more times within the last five years (increased from 10%). During the 2023 proxy season, only three proposals were successfully excluded under Rule 14a-8(i)(12) for failure to receive a sufficient level of support,[24] compared to five such successful exclusions in 2022 and one such successful exclusion in 2021. Notably, however, none of the three proposals excluded under Rule 14a-8(i)(12) in 2023 would have been excluded under the lower resubmission thresholds of the prior rules.

The Amended Rules also require each proponent to affirmatively state that the proponent is available to meet with the company, either in person or via teleconference, between 10 and 30 calendar days after the submission of the shareholder proposal, and each proponent must provide the company with contact information, as well as specific business days and times that the

[23] As noted above, success rates are calculated by dividing the number of no-action requests granted on a particular ground by the total number of no-action requests granted or denied on that ground.

[24] *Chevron Corp. (Unitarian Universalist Association)* (avail. Apr. 4, 2023)* (concurring with exclusion under Rule 14a-8(i)(12)(ii) where the similar proposal last received 12.38% of the votes cast, less than the 15% required); *CVS Health Corp. (Steiner)* (avail. Mar. 28, 2023) (concurring with exclusion under Rule 14a-8(i)(12)(iii) where the similar proposal last received 21.53% of the votes cast, less than the 25% required); *PNC Financial Services Group, Inc.* (avail. Feb. 28, 2023) (concurring with exclusion under Rule 14a-8(i)(12)(iii) where the similar proposal last received 7.69% of the votes cast, less than the 15% required).

proponent is available to meet with the company to discuss the proposal. In eight instances this season, compared to three instances in 2022, the Staff concurred with the exclusion of proposals where proponents did not provide such a statement of engagement availability. Notably, in two instances, as discussed below, the Staff also noted that the "[p]roponent has not provided sufficient proof of email delivery," and in one instance, the Staff noted that the proponent had not demonstrated, "solely by providing its asset manager's contact information, that it is 'apparent and self-evident' that the asset manager has authority to engage with the [c]ompany for purposes of Rule 14a-8(b)(1)(iii)."[25]

5. Noteworthy Procedural Challenges

This season saw the Staff address numerous procedural challenges. Notable challenges include:

- *Sufficient proof of email delivery must be provided.* As noted above, in two instances this season, companies challenged proposals under Rule 14a-8(f) where a proponent's representative did not provide a statement of engagement availability, as required under Rule 14a-8(b)(1)(iii).[26] In both instances, the company timely notified the representative of the deficiency, but received no response curing the defect. Immediately after the submission of both no-action requests, the representative sent to each company and the Staff photographs of emails that were purportedly timely sent, without forwarding the purported emails. The Staff granted exclusion in both instances, noting that the "[p]roponent has not provided sufficient proof of email delivery" and referencing SLB 14L, which provides that "[i]f a shareholder uses email to respond to a company's deficiency notice, the burden is on the shareholder or representative to use an appropriate email address (e.g., an email address provided by the company, or the email address of the counsel who sent the deficiency notice), and we encourage them to seek confirmation of receipt."

- *Procedural exclusion may be granted in unique instances, despite deficient company notices.* In one instance this season,[27] the Staff granted the exclusion of a proposal under Rule 14a-8(f) where the proponent failed to establish the requisite eligibility to submit the proposal as required under Rule 14a-8(b)(1)(i), while at the same time criticizing the company's deficiency notice notifying the proponent of the defect. The proposal, which was received by the company via FedEx, only contained the P.O. box address of the proponent's trust and no other contact information. The company mailed a timely deficiency notice to the proponent at the P.O. box address provided and received no response curing the deficiency. Following the submission of the no-action request seeking exclusion, the proponent alerted both the company and the Staff that he had not included other contact information in his submission materials for security purposes and did not regularly check the P.O. box address included in the materials, and, as a result, missed the deficiency notice sent by the company. The Staff granted exclusion of the proposal, noting that although "the [c]ompany's Rule 14a-8(f) notice was deficient in numerous respects, the [c]ompany did notify the [p]roponent of the problem – using the only method of contact that the [p]roponent provided." The Staff found that because the

[25] *Chevron Corp. (Meyer Memorial Trust (S))* (avail. Apr. 4, 2023)*.

[26] *Textron Inc.* (avail. Jan. 23, 2023)*; *The Allstate Corp.* (avail. Jan. 23, 2023).

[27] *Yum! Brands, Inc.* (avail. Mar. 31, 2023).

proponent did not check the singular method of contact provided until *after* the deadline for responding to the deficiency notice, the proponent's failure to remedy the defect "could not have been caused by the inaccuracy and incompleteness of the deficiency notice."

- *Manner of deficiency notice delivery matters.* In one instance this season, the Staff indicated in its response to the company's no-action request that it was unable to concur with exclusion of a proposal because the Staff claimed it was unable to determine if the proponent had timely received the company's deficiency notice because of the manner in which the company sent the deficiency notice. The deficiency notice was sent via overnight delivery to the proponent at a multi-unit complex, no signature was obtained upon delivery, and the company did not send a copy by email to the proponent.

- *Specificity in the wording of deficiency notices.* In one instance this season, while the Staff found that a proponent's submission was deficient under Rule 14a-8(b)(1)(iii) because it did not contain the proponent's contact information, the Staff denied relief and criticized the company's deficiency notice, stating that "rather than focusing on the defect, the [c]ompany's deficiency notice asserted that the Rule 14a-8(b)(1)(iii) statement already provided was wholly inadequate because it came from the [p]roponent's representative instead of from the [p]roponent." The Staff also noted that a proponent's representative may send this information on behalf of a proponent.

6. Third Party Attempts to Intervene in No-Action Request Process

While stakeholder activism has historically focused on the submission of shareholder proposals, the past several years have demonstrated the increasing politicization of the shareholder proposal process. And the 2023 proxy season marked a notable development in the evolution of stakeholder activism in this process—in at least one instance this season, a third party sought to intervene in the consideration by the Staff of a pending no-action request. The third party, which had no known relationship to the shareholder proponent that submitted the proposal, sent the Staff a response to the no-action request arguing against exclusion of the proposal. In its response to the third party's letter, the company argued that allowing third parties to intervene in the no-action process is inconsistent with Rule 14a-8, would increase the administrative burdens on companies and shareholder proponents as well as place additional pressure on the Staff's resources, would encourage submissions by a multitude of third parties whose interests may not be aligned with those of shareholders (or even the shareholder proponent), and would inappropriately turn the no-action request process into a forum for public policy debates. The Staff ultimately concurred with the exclusion of the proposal for reasons unrelated to the attempted third-party intervention and did not include the third party's correspondence in the file posted on the SEC website with the company's no-action request.

IV. Key Shareholder Proposal Topics During the 2023 Proxy Season

A. Human Capital and Social Proposals

Proposals focused on nondiscrimination and diversity constituted the largest subcategory (representing 26%) of social proposals submitted in 2023. These proposals were largely focused on racial equity and civil rights, DEI efforts, and gender and racial pay equity. While many social proposals in 2023 were tied to race and equality issues, proposals focused on reproductive rights and human rights assessments gained momentum. The 2023 proxy season also saw a significant rise in social proposals directly challenging the traditional ESG consensus. These ESG-skeptic social proposals included proposals requesting that companies, among other things, roll back plans to undertake a racial equity audit, conduct a cost/benefit analysis of DEI programs, conduct a racial equity and "return to merit" audit, and report on risks of supporting reproductive rights.

1. Racial Equity/Civil Rights Audit and Nondiscrimination Proposals

In 2023, there were 55 shareholder proposals that addressed issues of racial equity and civil rights, including workplace discrimination, audits of workplace practices and policies, and related topics, compared to 51 similar proposals submitted in 2022 and 38 in 2021.

The most frequent type of these proposals were 32 proposals calling for a racial equity or civil rights audit analyzing each company's impacts on the "civil rights of company stakeholders" or "civil rights, diversity, equity, and inclusion." Similar to prior years, these proposals often included the required or optional use of a third party to conduct the audit, with input to be solicited from employees, customers, civil rights organizations, and other stakeholders. These proposals were primarily submitted by the Service Employees International Union, with other filers including the New York State Comptroller (on behalf of the New York State Common Retirement Fund), Trillium Asset Management, and As You Sow. Fourteen of these proposals went to a vote, with ISS generally recommending votes "against" the proposal and average support of 22.4%, down from 21 such proposals that went to a vote in 2022, with average support of 45.3%. Four companies unsuccessfully sought to exclude a racial equity/civil rights audit proposal, arguing for exclusion on ordinary business, resubmission, substantial implementation, violation of law, vagueness or false/misleading, or procedural grounds.

The remaining 23 proposals related to workplace nondiscrimination, including requests to report on the prevention of workplace harassment and discrimination, eliminating discrimination through inclusive hiring, and requests to commission a non-discrimination audit analyzing the impacts of the company's DEI policies on "civil rights, non-discrimination, and return to merit." Of these, 13 proposals, including each of the "return to merit" proposals, were ESG-skeptic proposals submitted by the National Center for Public Policy Research ("NCPPR") and The Bahnsen Family Trust, with supporting statements that focused on concerns about discrimination against "non-diverse" employees or discrimination based on religious and political views. Five companies sought to exclude workplace nondiscrimination proposals, three of which were successful on procedural grounds.[28] The 12 proposals that went to a vote averaged 10.3% support, with ESG-skeptic social proposals garnering an average of only 1.5% support.

[28] *CVS Health Corp. (Baker)* (avail. Mar. 28, 2023); *The Coca-Cola Co.* (avail. Feb. 21, 2023); *Deere & Co.* (avail. Dec. 5, 2022).

2. Diversity, Equity, and Inclusion Efforts and Metrics

The number of proposals requesting disclosure of DEI data or metrics or reporting on the effectiveness of DEI efforts or programs remained relatively flat, with 35 such proposals submitted in 2023 and 34 submitted in 2022, up from 21 comparable proposals submitted in 2021. Of these, 25 proposals were withdrawn or otherwise not included in the proxy statement and five went to a vote with average support of 29.3%. One proposal received majority support, with 57.3% of votes cast in favor, at Expeditors International of Washington, Inc. Three companies sought exclusion of DEI proposals via no-action request, two of which were withdrawn and one of which was unsuccessful. As in 2022 and 2021, As You Sow was the main driver behind these proposals, submitting or co-filing 27 DEI proposals, 21 of which were withdrawn. Other filers included the New York State Comptroller on behalf of the New York State Common Retirement Fund (submitting two proposals), Amalgamated Bank (submitting three proposals co-filed by As You Sow), and Myra Young (submitting four proposals, three of which were co-filed by As You Sow).

3. Gender/Racial Pay Gap

The number of shareholder proposals calling for a report on the size of a company's gender and racial pay gap and policies and goals to reduce that gap increased during the 2023 proxy season. In 2023, shareholders submitted 16 proposals (up from nine proposals submitted in 2022), including two resubmissions to companies that received pay gap proposals last year. Six gender/racial pay gap proposals were submitted by Arjuna Capital and 10 were submitted by James McRitchie and/or Myra Young. Average support for these proposals decreased in 2023 as compared to 2022: the nine proposals voted on in 2023 received average support of 31.7% (with none receiving majority support), a significant decrease from average support of 42.6% for the five proposals voted on in 2022 (with two receiving majority support). Six proposals were not included in the company's proxy statement, with one proposal withdrawn after the company agreed to disclose quantitative median and statistically adjusted pay gaps. Each of these proposals targeted unadjusted pay gaps. In addition, where the company did not already provide adjusted wage gap information for comparable jobs (*i.e.*, what women and ethnic minorities are paid compared to their most directly comparable male and nonminority peers, adjusted for seniority, geography, and other factors), the proposals requested that the company also provide adjusted pay gap disclosure.

4. Reproductive Rights

In the wake of the overturn of *Roe v. Wade*, a focus area for the 2023 proxy season involved shareholder proposals requesting a report on the effect of reproductive healthcare legislation, including risks from state policies imposing restrictions on reproductive rights (including impacts on employee hiring, retention, and productivity) or on risks related to fulfilling information requests for enforcement of laws criminalizing abortion access. One ESG-skeptic proposal was submitted, requesting a report on risks and costs associated with opposing or altering company policy in response to state policies regulating abortion, with the supporting statement focusing on concerns that the company took a "pro-abortion stance" by opposing pro-life legislation and offering employees health coverage for travel costs. The number of reproductive rights proposals increased this season, with 22 such proposals submitted in 2023, up from four comparable proposals submitted in 2022, including three resubmissions to companies that received these proposals last year. The main proponents were Arjuna Capital, Tara Health

Foundation, and Change Finance P.B.C. Five companies sought to exclude these proposals, arguing for exclusion on ordinary business, micromanagement, and/or procedural grounds, but three requests were unsuccessful and the remaining two requests were withdrawn. Average support for these proposals decreased in 2023 as compared to 2022: the 11 proposals voted on in 2023 received average support of 10.8% (with none receiving majority support), a significant decrease from average support of 22.3% for the two proposals voted on in 2022.

5. Human Rights

The number of shareholder proposals relating to human rights, including those calling for a report on or an impact assessment of risks of doing business in countries with significant human rights concerns or for an assessment of the human rights impacts of certain products or operations, increased during the 2023 proxy season. In 2023, shareholders submitted 37 human rights proposals (up from 16 proposals submitted in 2022), including seven to companies that received human rights proposals last year. Fourteen of these proposals were ESG-skeptic proposals submitted primarily by the National Legal and Policy Center ("NLPC") and NCPPR, generally requesting reports on the risk of the company's operations in China. The 24 human rights proposals voted on received average support of 12.3% overall, with the proposals focused on operations in China receiving average support of 4.9% and the remainder receiving average support of 19.6%. Five companies sought to exclude these proposals via no-action requests, but only one was successful on resubmission grounds; two that argued for exclusion on ordinary business, micromanagement, and vagueness or false/misleading grounds were unsuccessful, and the remaining two were withdrawn.

B. Continued Focus on Climate Change and Environmental Proposals

As was the case in 2022, climate change-related proposals were the largest group of environmental shareholder proposals in 2023 by a large margin, representing 80% of all environmental proposals (and 17% of all proposals) submitted. There were 150 climate change-related proposals submitted in 2023, up from 130 proposals submitted in 2022 and 83 proposals submitted in 2021. This season also saw an increase in the number of environmental and climate change proposals excluded via no-action requests, with 13 excluded during the 2023 season (five were excluded on procedural grounds, one was excluded on substantial implementation grounds, and seven were excluded on ordinary business or micromanagement grounds), and five were excluded during the 2022 season (four were excluded on procedural grounds and one was excluded on substantial implementation grounds). Consistent with the overall rise in the success of ordinary business arguments more generally (as described in Part III above), the rise in environmental and climate change proposals excluded via no-action request can be at least partially attributed to the fact that some proponents have drafted more prescriptive proposals. In 2023, three environmental proposals were excluded as relating to the company's ordinary business matters, all of which requested that healthcare companies serve plant-based food options in their hospitals,[29] and four climate change proposals were excluded on

[29] *UnitedHealth Group Inc.* (avail. Mar. 16, 2023); *Elevance Health, Inc. (Beyond Investing LLC)* (avail. Mar. 6, 2023)*; *HCA Healthcare, Inc. (Beyond Investing LLC)* (avail. Mar. 6, 2023).

micromanagement grounds, two seeking detailed information on asset retirement obligations[30] and two seeking implementation of specific accounting methods.[31]

Climate change proposals took various forms, including requesting adoption of GHG emissions reduction targets (usually in alignment with net zero scenarios), disclosure of climate transition plans, disclosures regarding climate-related lobbying, changes to investments in and underwriting policies relating to fossil fuel production projects, and disclosures of risks related to climate change. Of these, the most common were proposals focusing on GHG emissions reductions targets and climate transition plans. Other popular climate change proposals included 17 proposals related to climate lobbying aligned with the Paris Agreement, nine proposals that requested the company phase out underwriting and lending for new fossil fuel exploration and development projects, and six proposals related to stranded carbon assets and asset retirement obligations due to energy companies' decommissioning of refineries. As with social proposals, there was also a rise in climate change proposals from the ESG-skeptic perspective, including proposals calling for a board committee to analyze risks of committing to decarbonization, reports on the feasibility of achieving the company's net zero targets, and requests to "rescind" a prior shareholder proposal requesting adoption of Scope 3 emissions reduction targets.

Continuing the trend from 2022, while the number of climate change proposals submitted and voted on increased significantly in 2023 compared to prior years, the average support for these proposals, the number receiving majority support and the withdrawal rates of these proposals are all at their lowest rates in at least three years. Similarly, ISS support for climate change proposals in 2023 decreased significantly, with ISS recommending votes "for" 47% of climate change proposals, down from 61% in 2022. This dramatic shift is likely largely due to the rise of more prescriptive proposals that went to a vote. As opposed to proposals seeking disclosure of company policies and practices related to climate change, these proposals related to specific business decisions that the company should undertake. For example, proposals focused on barring financial and insurance companies from underwriting or lending for new fossil fuel development received average support of 7.2%. By contrast, less prescriptive proposals seeking disclosure of companies' climate transition plans received average support of 26.9%.

30 *Phillips 66* (avail. Mar. 20, 2023)*; *Valero Energy Corp.* (avail. Mar. 20, 2023).

31 *Amazon.com, Inc.* (avail. Apr. 7, 2023, *recon. denied* Apr. 20, 2023)* (seeking measurement and disclosure of specific activities encompassed in the company's Scope 3 GHG emissions reporting); *Chubb Limited (Green Century Equity Fund)* (avail. Mar. 27, 2023) (seeking the phase out of underwriting risks associated with new fossil fuel exploration and development projects as a method for aligning the company's activities with limiting global temperature rise to 1.5 degrees Celsius).

Climate Change Proposal Statistics: 2023 vs. 2022			
	2023	2022	2023 vs. 2022
Submitted	150	130	↑16%
Voted on	70	41	↑73%
Average support	22.0%	33.4%	↓35%
Majority support	2	9	↓78%
Withdrawn (as percentage of submitted)	30%	52%	↓42%

1. Climate Transition Plans

There were 37 shareholder proposals submitted that related to issuing a climate transition report disclosing the company's GHG emissions reduction targets as well as policies, strategies, and progress made toward achieving those targets. These proposals usually called for long-term GHG emissions targets that cover Scopes 1, 2, and 3 emissions and that are in alignment with a 1.5 degree Celsius net zero scenario and the Science Based Targets initiative, including by asking companies to expand established emissions targets that do not meet these requirements. The supporting statements of these proposals frequently referenced concerns that disclosure of emissions reduction targets is not enough to address climate risk or provide sufficient accountability for achieving those targets and that investors would benefit from increased disclosure regarding the company's strategies to achieve those targets, including relevant timelines and metrics against which to measure progress. Five climate transition plan proposals focused on the impact of the company's climate transition strategy on relevant stakeholders under the International Labour Organization's "just transition" guidelines. Four climate transition proposals targeted financial institutions and called for transition plans to align the company's financing activities with its GHG emissions reduction targets, citing each company's membership in the Net Zero Banking Alliance. The primary proponents of these proposals were As You Sow (submitting 19 proposals), Green Century Capital Management (submitting five proposals), and Mercy Investment Services (submitting three proposals). Most of these proposals (a total of 25) were withdrawn or otherwise not included in the company's proxy statement, with 12 going to a vote, of which nine were voted on as of June 1, 2023, receiving average support of 28.7%.

2. Continued Focus on GHG Emissions

There were 52 proposals submitted related to measuring GHG emissions or adoption of GHG emissions reduction targets, typically in alignment with the Paris Agreement and often time-bound and covering all three scopes of emissions. Two of these proposals requested that the company recalculate its GHG emissions baseline to exclude emissions from material divestitures, both of which went to a vote (one after an unsuccessful no-action request arguing for exclusion on multiple proposals grounds), receiving average support of 18.4%. Two GHG emissions proposals were submitted by ESG-skeptic shareholder proponents, with one calling for the company to "rescind" a shareholder proposal to reduce Scope 3 GHG emissions that received majority support in 2021 and another requesting a report on the company's progress toward and feasibility of achieving net zero emissions by 2025 with a supporting statement that focused on obstacles to achieving net zero and expressed concerns that the company's net zero targets equate to "a false and misleading promise." Six companies sought to exclude GHG emissions proposals via no-action request, arguing for exclusion on ordinary business, micromanagement, multiple proposals, and substantial implementation grounds. Two requests were successful, one on procedural grounds and one that involved a proposal that requested that the company "measure and disclose scope 3 GHG emissions from its full value chain" and defined that to include scope 3 emissions of certain customers. The company argued that the proposal sought to micromanage the company by dictating the methodology and scope of activities included in the company's Scope 3 emissions reporting, thus limiting management's discretion in this regard.[32] A majority of the emissions-focused proposals (28) were voted on, receiving average support of 24.8%.

3. Other Environmental Proposals

Other popular environmental proposals (not related to climate change) predominantly focused on plastic pollution and sustainable packaging (totaling 14 of the 38 non-climate environmental proposals submitted in 2023), deforestation in supply chains (eight proposals), and other sustainability practices. Five non-climate environmental proposals were excluded via no-action requests: two on procedural grounds, and three on ordinary business grounds (which, as described above, all related to serving plant-based food options in the company's hospitals). Of the remaining proposals, 17 were withdrawn or otherwise not included in the company's proxy statement and 11 were voted on (and averaged 17.3% support). Of the 11 proposals voted on so far, six related to plastic use, plastic pollution, or sustainable packaging materials; one related to environmental and health impacts of the company's operations; one related to deforestation; one related to supply chain water risks; one related to impacts of oil spills; and one related to plant-based milk pricing. None of the proposals received majority support, and the highest level of support received were proposals relating to the use of plastics, which received between 25.3% and 36.9% support.

C. A New Governance Topic: Advance Notice Bylaws

A new focus area for the 2023 proxy season involved 28 shareholder proposals requesting that the company amend its bylaws to require shareholder approval for certain advance notice bylaw amendments, including timing of nominations, disclosure requirements for director nominees, and disclosure of nominating shareholders' affiliates. These proposals were in response to the adoption of changes made by companies to the advance notice provisions in their bylaws following the SEC's adoption of new universal proxy card rules in November 2021, which became effective in August 2022.[33] In support of these proposals, shareholder proponents expressed concern that certain bylaw amendments would make it burdensome for shareholders to nominate directors. All 28 of these proposals were submitted by John Chevedden's associates, primarily James McRitchie. Five no-action requests were submitted on this topic, and all were withdrawn. Nine of these proposals were withdrawn or otherwise not included in the company's proxy statement, and the remaining 19 went to a vote, with those voted on so far garnering average shareholder support of 13.8%. ISS recommended votes "against" all 11 advance notice bylaws proposals that received a recommendation as of June 1, 2023.

[32] *Amazon.com, Inc.* (avail. Apr. 7, 2023, *recon. denied* Apr. 20, 2023)*.

[33] For a detailed discussion of the SEC's universal proxy rules, *see SEC Adopts Rules Mandating Use of Universal Proxy Card*, Gibson Dunn (Nov. 18, 2021), *available here*.

D. The Return of Independent Board Chair Proposals

Although submissions focusing on governance topics were generally down this season, there was a significant increase in the number of proposals related to policies of separating the roles of chair of the board and CEO, which was the most frequent corporate governance proposal topic in 2023. There were 85 independent board chair proposals submitted this season, up from 50 proposals in 2022. Of the 85 independent board chair proposals submitted, at least 70 were submitted by John Chevedden and/or his associates, including Kenneth Steiner and Myra Young, and nine were submitted by the NLPC, which has historically not focused on the submission of proposals related to governance topics. Six proposals[34] were excluded via no-action requests, two on procedural grounds,[35] two on duplication grounds,[36] one on substantial implementation grounds,[37] and one on resubmission grounds.[38] The remaining 79 proposals were or will be voted on at company annual meetings, compared with only 40 proposals voted on in 2022. The 72 independent board chair proposals voted on so far this year received average shareholder support of 29.8%, in line with 2022 results, with no proposals receiving majority support. Notably, the proposals submitted by the NLPC received average shareholder support of 21.2%, compared to average shareholder support of 30.9% for the remaining proposals.

E. Increase in Proposals Focused on Shareholder Approval of Severance Agreements

Overall, the number of executive compensation shareholder proposals received by companies more than doubled this season. In 2023, 75 proposals focused on executive compensation were submitted, up from 36 proposals in 2022. This increase was largely attributable to the marked increase in proposals seeking shareholder approval of certain executive severance agreements, the most common executive compensation proposal received by companies.

Forty-seven proposals requesting boards seek shareholder approval of severance agreements were submitted in 2023, up markedly from 16 such proposals in 2022. These proposals typically requested that boards seek shareholder approval of any senior manager's new or renewed pay package that provided for severance or termination payments with an estimated value exceeding a certain multiple (usually 2.99x) of the executive's base salary and bonus. At least 43 of these 47 proposals were submitted by John Chevedden and/or his associates. Nine companies sought to exclude these proposals via no-action requests, seven of which were successful on procedural grounds.[39] The two remaining companies were denied relief, one arguing for exclusion on procedural grounds and one on substantial implementation grounds. Proposals seeking shareholder approval of severance agreements that went to a vote received average shareholder support of 23.8%, with two proposals receiving majority shareholder support. At numerous

[34] In one additional instance, the Staff concurred with exclusion of an independent chair proposal on procedural grounds, but the proposal was still included in the company's proxy statement and voted on. *See Laboratory Corp. of America Holdings (Chevedden)* (avail. Mar. 22, 2023).

[35] *The Allstate Corp.* (avail. Jan. 23, 2023); *Textron Inc.* (avail. Jan. 23, 2023)*.

[36] *PepsiCo, Inc.* (avail. Mar. 7, 2023)*; *Bank of America Corp. (Steiner)* (avail. Jan. 23, 2023)*.

[37] *Anavex Life Sciences Corp.* (avail. May 2, 2023).

[38] *CVS Health Corp. (Steiner)* (avail. Mar. 28, 2023).

[39] *Rite Aid Corp.* (avail. Apr. 12, 2023); *AMC Networks Inc.* (avail. Apr. 4, 2023); *JetBlue Airways Corp.* (avail. Jan. 19, 2023); *Kohls Corp.* (avail. Jan. 12, 2023); *The Walt Disney Co.* (avail. Dec. 5, 2022); *Visa Inc.* (avail. Nov. 8, 2022)*; *Walgreens Boots Alliance, Inc. (Chevedden)* (avail. Nov. 8, 2022)*.

companies, voting results were significantly affected by whether companies already had in place or, in response to the proposal, adopted policies addressing key aspects of the proposal.

F. Overall Decline in Civic Engagement Proposals but Congruency Proposals on the Rise

This season saw a decrease in the submission of proposals focusing on civic engagement, with the number of proposals addressing lobbying policies and practices disclosure, political contributions disclosure, and charitable contributions disclosure all declining (a total of 97 civic engagement proposals were submitted in 2023, compared to 106 in 2022). However, proposals focused on the alignment or congruency of a company's political contributions or lobbying expenditures with the company's publicly stated values saw an increase this season, with 21 such proposals submitted in 2023, compared to 14 such proposals in 2022.

Many of the new types of civic engagement shareholder proposals this season were ESG-skeptic proposals focused on the company's political speech or affiliations with certain entities. For example, NCPPR submitted six proposals requesting a report on the congruency of the company's partnerships with globalist organizations, expressing concerns about the company's affiliation with particular organizations (such as the World Economic Forum, Council on Foreign Relations, and Business Roundtable) that support stakeholder theory and that have agendas the proponent believes are incongruent with the company's fiduciary duty to shareholders. Three of these proposals went to a vote with the two voted on so far averaging support of 1.3%, and the remaining proposals were either excluded via no-action requests on procedural grounds or withdrawn. Other new proposals included three proposals submitted by The Bahnsen Family Trust relating to the company's involvement in "non-core" political issues (two of which were excluded via no-action request on ordinary business grounds and the other was withdrawn) and two proposals submitted by Ridgeline Research's American Conservative Values ETF requesting that companies encourage senior management to commit to avoiding political speech (both went to a vote with average support of 1.3%).

Overall, civic engagement proposals received average shareholder support of 22.9% in 2023. Thirty-four proposals focused on lobbying were submitted in 2023, compared with 46 proposals in 2022, with the 17 proposals that were voted on receiving average shareholder support of 32.9%, consistent with 33.1% support in 2022. Thirty proposals focused on political spending were submitted in 2023, compared with 36 proposals submitted in 2022, with the 12 proposals voted on receiving average shareholder support of about 20.6% (compared to 26.9% in 2022). Proposals focused on charitable contributions saw the biggest decrease in 2023, with three proposals submitted, compared with 13 in 2022, with the one that went to a vote receiving 7.4% shareholder support (compared to an average of 4.1% in 2022). Twenty-one proposals focused on congruency of political spending or lobbying with company values were submitted in 2023, compared with 14 in 2022, with the 13 voted on receiving average shareholder support of 19.1% (compared to 37.8% in 2022).

V. OTHER IMPORTANT TAKEAWAYS FROM THE 2023 PROXY SEASON

A. More Regulatory Change On the Horizon—Waiting on the SEC and Congress

1. SEC Amendment of Rule 14a-8

As discussed above, the 2023 proxy season was only the second season following the application of the Amended Rules, which were adopted by the SEC in September 2020. Following their adoption, opponents of the Amended Rules expressed concern that the increased stock ownership thresholds, additional procedural requirements, and higher resubmission thresholds could have a chilling effect on shareholders' ability "to use the shareholder proposal process to hold corporate boards and executives accountable on corporate governance and risk management."[40] However, those dire predictions have yet to materialize, as the impact of the Amended Rules has been relatively modest—shareholder proposal submissions have skyrocketed and exclusions on the basis of the Amended Rules have been relatively few and far between.[41]

Since the adoption of the Amended Rules, the pendulum has shifted in favor of shareholder proponents, as demonstrated by the Staff's issuance of SLB 14L in November 2021. And now more change is on the way in the form of significant amendments to Rule 14a-8 proposed by the SEC in July 2022 (the "2022 Proposed Amendments"). If adopted, the 2022 Proposed Amendments would formally modify three substantive bases for exclusion of shareholder proposals—substantial implementation, duplication, and resubmission.[42] In keeping with the thrust of SLB 14L and other efforts undertaken by the SEC since 2021, the 2022 Proposed Amendments would have the effect of further limiting the availability of these grounds for exclusion, likely leading to more shareholder proposals going to a vote.

a. Substantial Implementation

Under the current substantial implementation standard, a company may exclude a shareholder proposal "if the company has already substantially implemented the proposal."[43] The determination of whether a company has already substantially implemented a proposal tends to be fact-intensive, and the Staff has applied various interpretive frameworks when evaluating arguments for exclusion on this ground. Notably, however, under existing Staff guidance, a proposal "may be viewed as substantially implemented even if a company has not implemented all of the proposal's elements."[44] The 2022 Proposed Amendments would amend the language of Rule 14a-8(i)(10) to allow a company to exclude a proposal only "[i]f the company has already implemented the *essential elements* of the proposal" (emphasis added). Importantly, under the 2022 Proposed Amendments, substantial implementation would only be available if the company

40 *See Investors and Consumer Groups Urge Members of Congress to Overturn Trump-Era SEC Rule Changes*, ICCR (Apr. 22, 2021), *available here*.

41 For example, during the 2023 proxy season, only 11 proposals were excluded under the heightened requirements of the Amended Rules (three proposals were successfully excluded under the higher resubmission thresholds of the Amended Rules and eight proposals were excluded because proponents did not provide the required statement of engagement availability), representing only 1.2% of proposals submitted in 2023.

42 *See* Release No. 34-95267 (the "2022 Proposing Release"), *available here*.

43 Rule 14a-8(i)(10).

44 2022 Proposing Release at 12.

has implemented *all* of the proposal's essential elements. Moreover, the 2022 Proposing Release made clear that the concept of "essential elements" will be subjectively and broadly interpreted by the Staff. For example, a shareholder proposal requesting a report from a company's board of directors would not be excludable under the 2022 Proposed Amendments on substantial implementation grounds, even if the company publishes an identical report issued by the company's management, because the report did not come from the same entity requested in the proposal.

b. Duplication

The 2022 Proposed Amendments would also significantly change how the duplication standard under Rule 14a-8(i)(11) is applied. Under the existing standard, a company may exclude a shareholder proposal if it "substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting" so that shareholders will not have to consider two or more substantially identical proposals on the same ballot. When evaluating no-action requests arguing this ground, the Staff has historically considered whether the proposals share a common "principal thrust" or "principal focus." The 2022 Proposed Amendments would amend Rule 14a-8(i)(11) to provide that a proposal "substantially duplicates" another proposal if it "addresses the *same subject matter* and seeks the *same objective by the same means*" (emphasis added). Thus, in order to qualify for exclusion on this ground, proposals would need to more closely overlap and have both a shared objective and a shared approach for how that objective can be met.

c. Resubmissions

Finally, the 2022 Proposed Amendments would amend the framework used to analyze whether a proposal may be excluded under Rule 14a-8(i)(12), which allows a company to exclude a shareholder proposal that "addresses substantially the same subject matter" as a proposal, or proposals, that was previously included in the company's proxy materials within the past five calendar years and that proposal, or proposals, failed to achieve specified voting thresholds. Historically, the Staff has analyzed whether the proposals at issue share the same "substantive concerns," rather than the "specific language or actions proposed" to address those concerns. Under the 2022 Proposed Amendments, in order for a proposal to be eligible for exclusion under Rule 14a-8(i)(2) the proposal must "substantially duplicate" the prior proposal, not just "address substantially the same subject matter." Thus, just as with the proposed changes to Rule 14a-8(i)(11), the proposed changes to the resubmission analysis would require that a proposal "seek the same objective by the same means" as the prior proposal, or proposals. The proposed changes to the analysis of the resubmission basis will make it significantly harder for companies to exclude proposals, even when shareholders have recently expressed very low support for proposals addressing the same subject matter.

d. Timing of SEC Approval

The 2022 Proposed Amendments were listed on the SEC's Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions (the "Reg Flex Agenda") when it was released on June 13, 2023.[45] The Reg Flex Agenda indicates that the 2022 Proposed Amendments remain in the Final Rule Stage and that the SEC is targeting adoption by October 2023. However, given the number of other pending rulemakings on the Reg Flex Agenda, including final adoption of the SEC's climate change rules and proposed rules for human capital management disclosure, it is unclear whether the SEC will meet its target date for adoption of the 2022 Proposed Amendments.

2. Congressional Efforts to Reform Rule 14-8

On February 3, 2023, House Financial Services Committee Chairman Patrick McHenry (R-NC) announced the formation of a Republican ESG Working Group, comprised of nine members and led by Representative Bill Huizenga (R-MI), "to combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals.".[46] The Working Group was established to "[r]eign in the SEC's regulatory overreach; [r]einforce the materiality standard as a pillar of our disclosure regime; [a]nd hold to account market participants who misuse the proxy process or their outsized influence to impose ideological preferences in ways that circumvent democratic lawmaking."

In June 2023, the ESG Working Group released an interim report outlining the group's preliminary key priorities and issues identified to date.[47] The report identifies reforming the Rule 14a-8 no-action request process as a key priority of the Working Group's focus on reforming the proxy voting system for retail investors. The report posited that the "no-action letter process has become a mechanism for SEC staff to project its views about the 'significance' of non-securities issues, rather than a process for ensuring shareholder proponents' interests are aligned with those of their fellow shareholders."

With July 2023 declared "ESG Month"[48] by Representative Andy Barr (R-KY), several Congressional hearings have been held on ESG-skeptic topics, with more to come. At a July 12, 2023 hearing of the full House Financial Services Committee entitled "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation" scheduled for July 12, 2023,[49] the committee introduced 18 legislative proposals targeting what the hearing memorandum characterized as "[t]he federal government's focus on costly non-material environmental, social, and political issues at the expense of sound financial regulation," including actions by the SEC "that facilitate the inclusion of politically motivated shareholder

[45] *Agency Rule List – Spring 2023 Securities and Exchange Commission, Office of Information and Regulatory Affairs* (2023), *available here*.

[46] Press Release, *McHenry Announces Financial Services Committee Republican ESG Working Group* (Feb. 3, 2023), *available here*.

[47] *Memorandum re Preliminary Report on ESG Climate Related Financial Services Concerns* (June 23, 2023), *available here*.

[48] Eleanor Mueller, *The leader of the House GOP's anti-ESG efforts*, Politico (July 5, 2023), *available here*.

[49] Press Release, *HEARING NOTICE: Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation* (July 5, 2023), *available here*.

proposals in annual proxy statements and reversing important reforms to proxy solicitation rules."[50] Among the 18 legislative proposals are six bills targeting the shareholder proposal process. If adopted in their current form, the proposed bills would (1) nullify the 2022 Proposed Amendments;[51] (2) increase the resubmission thresholds under Rule 14a-8(i)(12);[52] (3) permit exclusion of shareholder proposals if the subject matter of the proposal is "environmental, social, or political (or a similar subject matter)";[53] (4) permit exclusion of a shareholder proposal under Rule 14a-8(i) "without regard to whether such shareholder proposal relates to a significant social policy issue";[54] (5) prohibit the SEC from compelling the inclusion or discussion of shareholder proposals in a company's proxy statement;[55] and (6) require the SEC to conduct a study of issues related to the proxy process, including issues related to the costs, risks and impacts of the shareholder proposal process on companies and the U.S. economy.[56] While it is unlikely that any of the proposed bills would be approved in the Senate and receive Presidential approval, these bills underscore that the shareholder proposal process will continue to be the focus of scrutiny from U.S. lawmakers throughout the 2024 proxy season and beyond.

B. Legal Challenges to the Rule 14a-8 Process

The 2023 proxy season saw a new challenge to the SEC Staff's role in the shareholder proposal process emerge in a lawsuit filed by NCPPR in the U.S. Court of Appeals for the Fifth Circuit. In *National Center for Public Policy Research v. SEC*, the Fifth Circuit is being asked to address several important questions about the Rule 14a-8 process, including: (1) whether responses to no-action requests issued by the Staff to companies that concur that a company may properly exclude a proposal under Rule 14a-8 are subject to judicial review; (2) the scope of the ordinary business exception under Rule 14a-8(i)(7); and (3) whether Rule 14a-8's requirement that, absent an exception, companies include shareholder proposals in their proxy statements exceeds the SEC's authority under the Exchange Act or violates the First Amendment.

The case arose out of a proposal submitted to The Kroger Co. requesting that the company issue a report "detailing the potential risks associated with omitting 'viewpoint' and 'ideology' from its written equal employment opportunity (EEO) policy." The Staff concurred with Kroger's no-action request, which argued that NCPPR's proposal could be excluded on ordinary business grounds.[57] In response, NCPPR filed a petition for review of the Staff's no-action decision in the Fifth Circuit and asked the court to stay the no-action decision during the litigation. According to NCPPR, by granting Kroger's no-action request, the SEC Staff's actions were arbitrary and capricious and constituted unconstitutional viewpoint discrimination, because the Staff has refused to grant no-action letters regarding similar proposals addressing other types of

[50] Committee Memorandum, *Financial Services Committee Hearing entitled "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation"* (July 7, 2023), *available here*.

[51] *Available here*.

[52] *Available here*.

[53] *Available here*.

[54] *Available here*.

[55] *Available here*.

[56] *Available here*.

[57] *The Kroger Co.* (avail. Apr. 12, 2023).

discrimination, such as discrimination based on race, sex, or sexual orientation.[58] In its response opposing the administrative stay granted by the Fifth Circuit, the SEC argued that the Fifth Circuit lacked jurisdiction to review the no-action decision (a) because a no-action decision represents an informal, non-binding determination by the Staff, rather than a formal, dispositive determination by the SEC itself, (b) because it is not a "final order[ ] of the Commission" subject to judicial review, and (c) because decisions about whether to initiate an enforcement action are committed to an agency's unreviewable discretion.[59]

After the Fifth Circuit referred the case to the merits panel, Kroger filed its final proxy materials, which included NCPPR's shareholder proposal.[60] Several weeks later, the National Association of Manufacturers ("NAM") intervened in the litigation. NAM raised a far-reaching challenge to the existing Rule 14a-8 framework, arguing that the requirement under Rule 14a-8 that companies include shareholder proposals in their proxy statements (absent an exception) exceeds the SEC's authority under the Exchange Act and asserting that statutory provision only authorizes the SEC to target misleading or deceptive statements by a company in its proxy statement. NAM further argued that, if Rule 14a-8 is statutorily authorized, it violates the First Amendment because the rule requires companies to speak on controversial topics and alters the content of their speech in contravention of the Constitution's restrictions on compelled speech and content-based speech regulations. The SEC subsequently filed a motion to dismiss the case, and on July 12, 2023, the Fifth Circuit entered an order declining to rule on the SEC's motions to dismiss the litigation, referring the motions to the merits panel, which will decide the case (including the threshold jurisdictional issues) after further briefing and argument. A decision will likely be issued in the spring or summer of 2024 at the earliest.

Given the broad scope of matters involved in this litigation, it is possible that the Staff may invoke its longstanding policy to express no view on a company's intention to exclude a shareholder proposal from its proxy materials where the company's arguments are being considered in a court of law.[61] For example, the Staff may determine to express no view (and thus not grant any no-action requests) on the application of the ordinary business rule generally or with respect to purportedly similar shareholder proposals (*e.g.*, nondiscrimination proposals) during the pendency of this litigation. This could result in a significant number of shareholder proposals (regardless of the proponent) being included in company proxy statements absent the company successfully negotiating with the shareholder proponent for the proposal to be withdrawn.

[58] Notably, in 2022, the Staff permitted the exclusion of a substantially similar proposal submitted by NCPPR to BlackRock, Inc. on identical ordinary business grounds. *See BlackRock, Inc.* (avail. Apr. 4, 2022, *recon. denied* May 2, 2022).

[59] The SEC emphasized that every court of appeals to consider the question has held that no-action requests are not final orders and therefore are not subject to judicial review, and that the appropriate procedure for NCPPR to seek relief would be to file a suit against Kroger in district court.

[60] NCPPR's proposal was voted on at Kroger's 2023 annual meeting and received only 1.9% support.

[61] The Staff took this approach, for example, in the early 1990s during litigation involving the application of the ordinary business exception to shareholder proposals requesting implementation of nondiscrimination policies, and more recently during the 2015 proxy season while the SEC was reconsidering the application of the conflicting proposals exception in Rule 14a-8(i)(9).

C. Shareholder Use of Exempt Solicitations Continues to Grow

The use of exempt solicitation filings by shareholder proponents continued to grow unabated in 2023, including as part of efforts to generate greater publicity for their proposals in advance of shareholders' meetings or to address other topics. Under Rule 14a-6(g) under the Exchange Act, shareholders owning more than $5 million of a company's securities generally must file a Notice of Exempt Solicitation (an "Exempt Notice") on EDGAR when soliciting other shareholders on a topic without seeking to act as a proxy. The rule is one of several exempting certain solicitations from the proxy filing requirements, and it was designed to address concerns that institutional investors and other large shareholders would conduct "secret" solicitations. However, in recent years, these filings have primarily been used by smaller shareholders to publicize their views on various proposals, as EDGAR does not restrict their use of these filings. In this regard, approximately 71% of Exempt Notices filed in 2023 were identified as voluntary filings by shareholders who did not own more than $5 million in company stock, down from 80% in 2022. As a result, it seems that shareholders continue to use these filings outside of Rule 14a-6(g)'s intended scope, resulting in some compliance issues and potential confusion for other shareholders when evaluating the items to be voted on.

As of June 1, 2023, there were a record-high 347 Exempt Notices filed since the beginning of the calendar year, up from 285 as of the same date in 2022 and 211 as of the same date in 2021. Frequent filers included As You Sow with 48 filings (up from 26 in 2022), NLPC with 29 filings (up from zero in 2022), John Chevedden with 28 filings (down from 30 in 2022), New York State Common Retirement Fund with 18 filings (up from two in 2022), and Majority Action, LLC with 16 filings (down from 26 in 2022). All of the Exempt Notices filed by As You Sow, NLPC, Mr. Chevedden, and Majority Action, LLC were voluntary.

While shareholder proponents have routinely used Exempt Notices to advocate for the proposals they submit, there was noteworthy evolution in the use of Exempt Notices during the 2023 proxy season—namely the use of Exempt Notices by intervening third-parties to express their views on shareholder proposals submitted by other shareholder proponents with whom they have no apparent relationship. For example, The International Brotherhood of Teamsters filed an Exempt Notice urging shareholders of Chipotle Mexican Grill, Inc. to support a shareholder proposal submitted by the Comptroller of the City of New York, As You Sow, and the New York City Retirement System requesting the company adopt a policy of non-interference with freedom of association rights.[62] Similarly, NLPC filed Exempt Notices in support of a number of proposals submitted by the American Conservative Values ETF. Notably, NLPC also filed Exempt Notices to voice its opposition to several proposals submitted by shareholder proponents, including three climate change proposals submitted by the New York State Common Retirement Fund, As You Sow, and Trillium Asset Management at Bank of America Corp.,[63] a proposal regarding lending and underwriting of fossil fuel exploration and development submitted by Harrington Investments, Inc. at Citigroup Inc.,[64] and a proposal requesting a report on the risks

[62] *Available here.*

[63] *Available here.*

[64] *Available here.*

of doing business in states with restrictive abortion laws submitted by As You Sow at The Coca-Cola Co.[65]

Despite the continued growth in the use of exempt solicitations, the Staff has yet to address the continued potential for abuse. And that potential for abuse may be compounded if intervening third parties, who may or may not be shareholders, continue to use Exempt Notices to support or oppose shareholder proposals submitted by shareholder proponents.[66] We continue to recommend that companies both actively monitor their EDGAR file for these filings, review any Exempt Notices carefully and inform the Staff to the extent they believe an exempt solicitation filing contains materially false or misleading information or may not have been filed by a shareholder.[67]

D. Practice Pointers for the 2024 Proxy Season and Beyond

While the 2023 proxy season is just now concluding, companies should begin preparations for the 2024 proxy season now.

Companies should continue to monitor legislative, regulatory and other legal developments that may impact shareholder proposals during the 2024 proxy season. As noted above, following the Court's overturn of *Roe v. Wade* in 2022, the 2023 proxy season saw a renewed focus on shareholder proposals requesting a report on the effect of reproductive healthcare legislation. And most recently, the Court issued decisions on affirmative action at colleges and universities, ruling that institutions of higher education can no longer consider race in admissions decisions (subject to a narrow exception for remediating past discrimination) . It remains to be seen how the Court's decisions may impact shareholder proposals on DEI-related issues and companies' responses to such proposals in the coming proxy season.

As part of those preparations, companies would be well advised to review two key aspects of the deficiency notice process:

- *Review Language in Deficiency Notices*. In light of the Staff's focus on how companies explain procedural deficiencies, companies should carefully review their existing model language to assess whether it accurately and completely describes the requirements of Rule 14a-8. And when preparing deficiency notices for the 2024 proxy season, companies should take care to provide clear, plain English explanations of any identified procedural deficiencies.

- *Review Deficiency Notice Delivery Procedures.* As discussed above, the Staff is also keenly focused on the manner in which companies deliver deficiency notices to

[65] *Available here.*

[66] Unlike Exempt Notices filed by shareholder proponents, who were required to provide proof of their shareholder status when submitting their shareholder proposals, companies may be unable to confirm whether the intervening third parties are actually shareholders eligible to file Exempt Notices under Rule 14a-6(g).

[67] In 2018, the Staff published two new Compliance and Disclosure Interpretations ("C&DIs") providing some guidance on the use of Exempt Notices. Question 126.06 confirms the Staff's view that "voluntary" Notices of Exempt Solicitations can be filed, and Question 126.07 clarifies that each Notice of Exempt Solicitation, whether filed voluntarily or because it is required under Rule 14a-6(g), must include a notice page setting forth the information required under Rule 14a-103. Both C&DIs are available here.

shareholder proponents. Accordingly, companies should review their delivery procedures to assess whether, if challenged, they will have sufficient evidence to demonstrate that the proponent received the company's notice, even when the proponent claims otherwise.

The following Gibson Dunn attorneys assisted in preparing this update: Elizabeth Ising, Thomas J. Kim, Julia Lapitskaya, Ronald O. Mueller, Michael Titera, Lori Zyskowski, Geoffrey Walter, Victor Twu, Natalie Abshez, Meghan Sherley, Michael Svedman and Nicholas Whetstone.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, or any of the following lawyers in the firm's Securities Regulation and Corporate Governance practice group:

Aaron Briggs – San Francisco, CA (+1 415-393-8297, abriggs@gibsondunn.com)
Elizabeth Ising – Washington, D.C. (+1 202-955-8287, eising@gibsondunn.com)
Thomas J. Kim – Washington, D.C. (+1 202-887-3550, tkim@gibsondunn.com)
Julia Lapitskaya – New York, NY (+1 212-351-2354, jlapitskaya@gibsondunn.com)
Ronald O. Mueller – Washington, D.C. (+1 202-955-8671, rmueller@gibsondunn.com)
Michael Titera – Orange County, CA (+1 949-451-4365, mtitera@gibsondunn.com)
Lori Zyskowski – New York, NY (+1 212-351-2309, lzyskowski@gibsondunn.com)
Geoffrey E. Walter – Washington, D.C. (+1 202-887-3749, gwalter@gibsondunn.com)
David Korvin – Washington, D.C. (+1 202-887-3679, dkorvin@gibsondunn.com)

← Dodd-Frank Unfinished Business: Financial Institution Incentive Compensation | Main | Non-Competes: Chamber Challenges FTC Ban →

May 7, 2024

More On Financial Institution Incentive Compensation: Three Agencies Re-Propose Rule

It turns out the rumors were true. Yesterday, the FDIC, OCC and Federal Housing Finance Agency adopted a notice of proposed rulemaking to implement Section 956 of Dodd-Frank. According to this Sullivan & Cromwell memo, the re-proposed rule is generally consistent with the form proposed in 2016.

Keep in mind that the notice of proposed rulemaking will not be published in the Federal Register until all six agencies propose it, and the memo gives the status of the rule with each of the three remaining agencies:

> – The National Credit Union Administration is expected to propose the same rule in the near future.
> – The Securities and Exchange Commission has included a rulemaking to implement Section 956 of Dodd-Frank on its rulemaking agenda.
> – The Board of Governors of the Federal Reserve System has not joined the FDIC's, OCC's and FHFA's proposal.

Despite the delay in the formal comment period, the memo states that the FDIC, OCC and FHFA have each made the proposed rule text available on their websites and will accept comments. Take a look at the memo for a summary of key provisions.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2024/05/more-on-financial-institution-incentive-compensation-three-agencies-re-propose-rule.html