Comment on Certain Proposed Changes in ISS Policies

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I have comments related to four of ISS's proposed policy changes, relating to (1) Board Response to Management Say-on-Pay Vote; (2) Proxy Access Proposals; (3) Hydraulic Fracturing Proposals; and (4) Political Spending Proposals. I address the first three in turn and the fourth, in substantially more detail, in a separate comment on behalf of myself and others.

(1) Board Response to Management Say-on-Pay Vote

I generally agree with ISS's proposed policy of taking a CASE-BY-CASE approach to assessing board response to management say-on-pay (MSOP) votes. I would encourage ISS to proceed with caution, however, in pressing boards to react to non-majority shareholder NO votes on proposed pay packages, particularly in cases in which NO Vote campaigns have been launched against executive pay plans by investors affiliated with organized labor.

Among the 150 largest companies by revenues, which I studied for my recent *Proxy Monitor 2011* report,[1] the Association of State, County, and Municipal Employees actively campaigned against the pay packages at five companies—Alcoa, ConocoPhillips, ExxonMobil, Johnson & Johnson, and Pfizer—and four of these received under 70 percent shareholder support for their executive-compensation plans. (Alcoa received over 84 percent support, but only after modifying its proposed plan in reaction to labor complaints.)

Such labor involvement is concerning in light of the finding by the Office of the Inspector General of the U.S. Department of Labor (OIG), in March 2011, that it could not rule out the possibility that the managers of labor pension plans were using "plan assets to support or pursue proxy proposals for personal, social, legislative, regulatory, or public policy agendas, which have no clear connection to increasing the value of investments used for the payment of benefits or plan administrative expenses."[2] The OIG's observation echoes those long made by members of

[1] James R. Copland, *Proxy Monitor Report Fall 2011: A Report on Corporate Governance and Shareholder Activism*, *available at* http://www.proxymonitor.org/Reports/Proxy_Monitor_2011.pdf.
[2] OIG Department of Labor Report, *Proxy-Voting May Not Be Solely for the Economic Benefit of Retirement Plans*, Rpt. No. 09-11-001-12-121, intro (March 31, 2011), *available at* http://www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121.pdf.

the academic community, like Yale law professor Roberta Romano, who has noted that it is "quite probable that private benefits accrue to some investors" from shareholder proposals.[3]

My analysis of shareholder proposals submitted to the largest 150 U.S. public companies by revenues, from 2008 through August 1, 2011—drawn from the Manhattan Institute's Proxy Monitor database—heightens these concerns.[4] The data reveal that companies in service-oriented fields (telecommunications, retail, and financial services) have been much more likely to receive shareholder proposals sponsored by labor pension funds and other labor-affiliated investors than are companies in the manufacturing fields (including general manufacturing as well as energy, health care, and consumer products).

The sectors in which labor unions concentrate their shareholder proposals are less likely to be unionized—only 5.6 percent of Americans employed in retail trade and 2.5 percent of those employed in the financial sector are unionized, as compared with 8.8 percent in oil and gas extraction and 11.6 percent in manufacturing—and are the targets of unions' well-publicized recent organizing campaigns. Unions' particular focus on these sectors therefore may be related more to organizing campaigns than to maximizing share returns. Because the real possibility exists that labor-affiliated pension funds may be targeting executive pay plans at companies to extract concessions for the benefit of current union members rather than to increase investment value for all shareholders, ISS should scrutinize MSOP voting results carefully to discern an active union influence before expecting a board reaction to a substantial but non-majority NO vote on proposed pay.

(2) Proxy Access Proposals

I generally agree with ISS's proposed policy of taking a CASE-BY-CASE approach to assessing proxy access proposals. While such proposals might be justified to lower barriers to potential change-of-control transactions, they generally run the risk of empowering certain classes of shareholders to extract benefits from the company at the expense of the broader group of shareholders, as discussed in section (1) *infra*.

Indeed, just such concerns animated the D.C. Circuit's summer decision to vacate Securities Exchange Act Rule 14a-11, in *Business Roundtable v. SEC*,[5] when the Circuit credited

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[3] Roberta Romano, *Less Is More: Making Shareholder Activism a Valued Mechanism of Corporate Governance*, 18 YALE J. REG. 174, 231-32 (2001) ("It is quite probable that private benefits accrue to some investors from sponsoring at least some shareholder proposals. The disparity in identity of sponsors—the predominance of public and union funds, which, in contrast to private sector funds, are not in competition for investor dollars—is strongly suggestive of their presence.").

[4] *See* Copland, *supra* note 1, at 10-11.

[5] No. 10-1305, slip op. (D.C. Cir. Jul. 22, 2011), *available at* http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf.

commenters' "concern that these employee benefit funds would impose costs upon companies by using Rule 14a-11 as leverage to gain concessions, such as additional benefits for unionized employees, unrelated to shareholder value."[6] Such risks are particularly acute when proxy access hinges, as in the SEC's vacated rule, on not only a relatively modest share ownership threshold but a long holding period—effectively limiting the engagement of vulture investors, private equity investors, or hedge funds that might take advantage of a proxy access rule to facilitate the takeover of an underperforming company, since such investors will not normally hold shares for a three year period. The value of proxy access is likely limited in actual takeover situations, since a serious corporate raider should be more than willing to launch a traditional proxy fight; but there is at least a plausible case that proxy access might lower barriers to potential takeovers by 13D filers. In the general case, however, proxy access—certainly of the type proposed in 14a-11—should be disfavored.

(3) Hydraulic Fracturing Proposals

I disagree with ISS's proposed policy adopting a general VOTE FOR recommendation with regard to shareholder proposals calling for greater disclosure of companies hydraulic fracturing (fracking) operations. To date, no such proposal has received majority shareholder support for good reason: while natural gas fracking, like any energy extraction process, is not without environmental risks, there is no empirical evidence whatsoever that mandating boards to publish risk assessments specific to fracking improves share value.

Among the shareholder proposals contained in the Manhattan Institute's Proxy Monitor database—those submitted to the largest 150 U.S. public companies by revenues, from 2008 through August 1, 2011—not a single environmental or social proposal has passed over the period studied. Such proposals are commonplace and constitute 68 percent of all shareholder proposals submitted to companies in the energy and minerals sector.[7] Proposals commonly concern not only fracking but also oil drilling, wetlands preservation, coal combustion, greenhouse gas emissions, and general questions of sustainability.

Though it is true that proposals concerning fracking have received relatively more shareholder support than most others in this vein—including 40.5% at Chevron and 28.2% at Exxon Mobil in 2011—such support has fallen short of a majority and offers no justification for ISS's proposed general rule. There is no evidence that fracking creates greater environmental risk than, e.g., offshore oil drilling, nuclear waste disposal, or coal power,[8] and there is no basis for singling out fracking for special review for energy-company shareholders.

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[6] *Id.* at 13.
[7] *See* Copland, *supra* note 1, at 9.
[8] *Cf.* Robert Bryce, *Ten Reasons Why Natural Gas Will Fuel the Future*, No. 8 ENERGY & ENVIRONMENT RPT. 7-8 (Manhattan Inst. April 2011) ("Natural gas produces no solid waste, an attribute that has become increasingly important since the failure of a coal-ash holding pond operated by the Tennessee Valley Authority in late 2008. The

Rather than share value, the push for greater disclosure of fracking operations is likely intended to buttress a policy agenda opposing such development. Shareholder proposals have emerged as a frequent political tactic in political and public-policy campaigns—alongside community organizing, private litigation, and media efforts—as environmental and other activists pursue "investment strategies [that] directly target corporate stock prices, executives, and shareholders" in pursuit of their policy goals.[9] These "advocates typically pursue such resolutions because even if the resolutions do not pass, which they rarely do, they still raise the [activists'] concerns in a visible manner to the company's board of directors, management, employees, and shareholders"[10]—and, critically, the motivation behind such efforts is to generate support for a preferred policy position by *negatively* affecting share values and thereby building pressure on boards and managements to modify behaviors.

ISS should not reward such tactics with a general VOTE FOR recommendation in this area.

(4) Political Contribution Proposals

I disagree strongly with ISS's proposed shift in policy adopting a general VOTE FOR recommendation with regard to shareholder proposals calling for increased corporate disclosure of political contributions and spending. ISS's current CASE-BY-CASE policy is preferable for a variety of reasons, including: (1) the variation in companies' current policies with regards to political spending and disclosure; (2) the variation in companies' political realities and sensitivities to disclosure or non-disclosure by customer orientation and industry; and (3) the variation in the nature of various shareholder proposals themselves. Please refer to my separate comment submitted in conjunction with Stephen Bainbridge and Keith Bishop for further analysis on this proposal.

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spill flooded some 300 acres with coal ash contaminated with a variety of heavy metals including arsenic, lead, barium, chromium, and manganese. That accident has led the EPA to consider rules that could classify coal ash as a hazardous waste under the Resource Conservation and Recovery Act.").

[9] Jonathan C. Drimmer & Sarah R. Lamoree, *Think Globally, Sue Locally: Trends and Out-of-Court Tactics in Transnational Tort Actions*, 29 BERKELEY J. INT'L L. 456, 482 (2011).

[10] *Id.*

About the Commenter

James R. Copland is a Manhattan Institute senior fellow and has directed the Institute's Center for Legal Policy since 2003. In 2011, Mr. Copland launched the Institute's corporate-governance website, ProxyMonitor.org. The National Association of Corporate Directors named Copland to its NACD 100 List for 2011 based on his research and writing on corporate-governance topics.

Copland has written studies, book chapters, law review articles, and pieces in popular media including *The Wall Street Journal* and *The National Law Journal*. He has testified before Congress, is quoted frequently in the press, and regularly speaks on issues related to law and economics.

Prior to joining the Manhattan Institute, Copland was a management consultant with McKinsey and Company, primarily working in the firm's financial institutions practice. He had earlier served as a law clerk for Ralph K. Winter on the United States Court of Appeals for the Second Circuit. He has been a director of two privately held companies since 1997. Copland received a J.D. from Yale, where he was an Olin Fellow in Law and Economics and an editor of the *Yale Journal on Regulation*; an MBA from Yale, with a concentration in Finance; an M.Sc. in politics of the world economy from the London School of Economics; and a B.A. in economics with highest distinction and highest honors from the University of North Carolina at Chapel Hill.