Environmental Shareholder Proposals: Is Less More?

December 2019

Environmental Proposals – Engagement Takes Center Stage

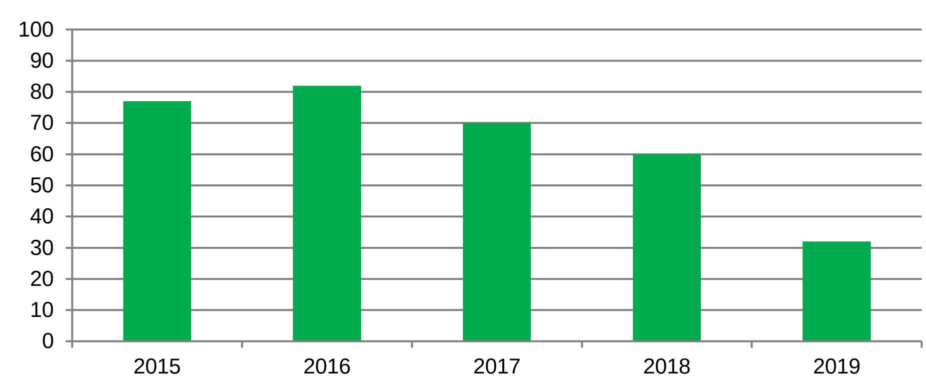
Companies with a large environmental footprint face a much wider array of public and private pressures today than ever before, coming from all types of stakeholder groups including regulators, communities, customers, current employees, pension beneficiaries, politicians, and of course both shareholders and debtholders as well.

Types of engagement. Engagement between investors and issuers around environmental issues typically falls into one of two categories: *engagement around the investment decision*, in which investors will use their ownership position to ask for companies to engage on particular issues, either publicly or in private, and *engagement around the voting decision*, which involves investors either proposing or supporting a particular shareholder proposal and engaging with the company to push it toward the changes suggested in said proposal.

Based on the flood of press releases from both companies and organizations, we'd suggest that issuers have become *more*, not *less* responsive, to organizations seeking to engage over time. Take, for example, the public response from many companies approached by *Ceres' Climate Action 100+* that have agreed to change their disclosures, or even change their operations going forward.

One question is what this expansion of engagement means for the venerable shareholder proposal process going forward, as the number of environmental proposals continues to decrease. With the limits for a proponent still sitting at a minimum of just a $2,000 investment (though the SEC has stated their intent to review), it remains an option for applying pressure to companies in both a private and public manner, and in fact may still be the most effective method for a small or mid-sized proponent to engage with a company. *Figure 1* shows the trend of environmental-focused proposals on US Russell 3000 companies over time – declining to just 32 in this latest year.

Figure 1: Environmental Shareholder Proposals Voted at Russell 3000 Companies, 2015-2019



Source: IHS Markit BD Corporate Governance

However, 2019 has proven a strange year for both issuers and shareholder proponents, and the nature of shareholder proposals may be very different in 2020. With the U.S. government shutdown in January 2019, the typical "no action" SEC response was suddenly unavailable to companies, many of whom went ahead with allowing proposals onto proxies until the SEC began reviewing such letters again on January 28. That said, it's possible that the compressed SEC review period led companies to negotiate more directly with shareholders; as evidence – based on a review of the energy and utilities companies that show "NOACT" correspondence with the SEC in 2019, 8 out of 38 total proposals were later withdrawn by their proponents after the no action stage.

The second SEC bombshell came over the summer, with the SEC's "after action" review of how it responded to the government shutdown leading to new guidance stating it will not necessarily respond to every NOACT request in written format the future, and may choose not to respond at all, leaving open the possibility that a company might sit in limbo waiting for a response.

This leaves a question mark over the upcoming shareholder proposal season – with the only certainty being that the new rules will lead to more, not less, direct engagement between proponents and companies. For each of these engagements, every company receiving a proposal should have a clear view of:

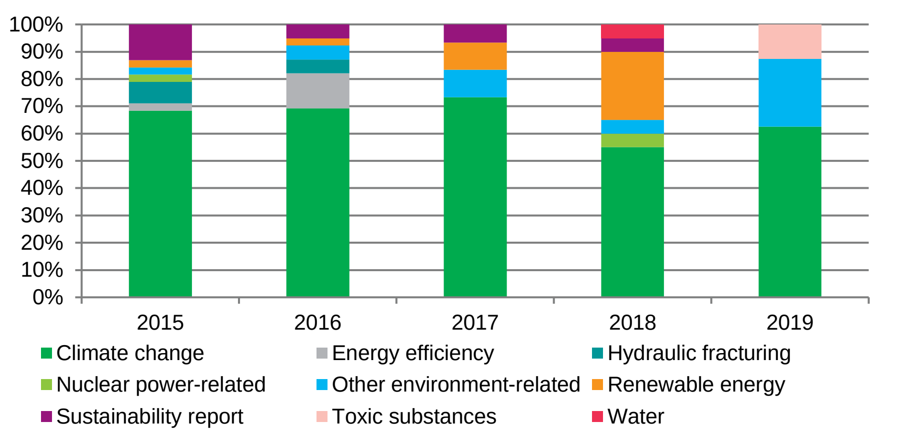
1. the proponent's history and background with similar proposals
2. the election results of similar proposals that have reached a vote
3. the composition of the company's current shareholder base and a projection of the likely results of the proposal

Of these, the first and second have definitive answers; the third, on the other hand, requires a bit more knowledge to create this estimate. Let's look at the tools we have to evaluate the first two using proposal data from proxy statements; then, we'll review how to look at your shareholder base and gauge risk.

Shareholder Proposals and Topics

Climate change and energy sector focus. The risks associated with the energy transition and physical impact of climate change have put the energy sector under greater scrutiny over the years, with oil and gas companies and utilities being the most targeted by shareholders activism and their strategic use of their voting rights. Data from proxy statements show that climate-related resolutions account for most of the environment-focused resolutions tabled over the past five years in the sector. *Figure 2* shows the increasing concentration of shareholder proposal types, particularly into the climate change realm (such as "publish climate change report" proposals that have received shareholder support consistently over the years).

Figure 2: Themes of Environmental-focused Shareholder Proposals in US Energy Companies - 2015 - 2019 (%)



Source: IHS Markit

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Since the Paris Agreement reached in 2015, investors' attention to climate change has significantly increased. As political and social pressure is mounting, the investor community is looking more closely at climate indicators to better understand the potential risks and opportunities and how they may impact their companies' financial performance.

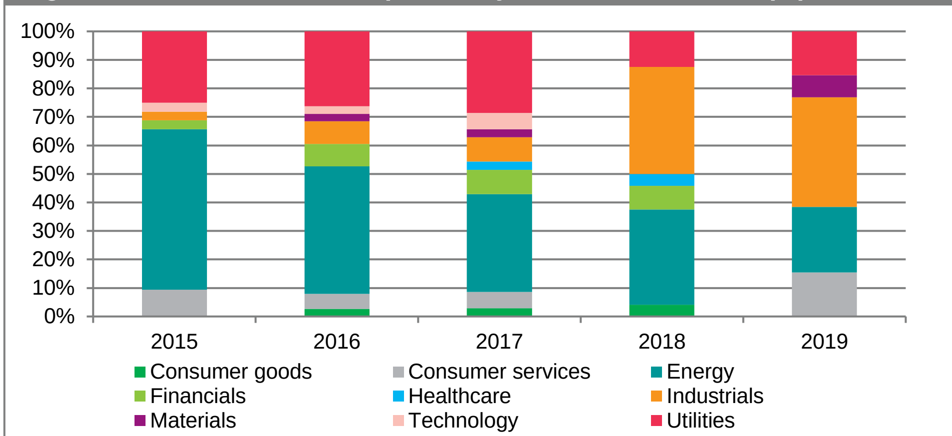
This growing concern around the impact of climate change has generated a shift in investors' focus and led to greater convergence of action around a number of asks for their issuers, starting from climate risks disclosure, to emission reduction targets, climate stress testing and climate risk governance. To this end, the recommendations of the Task Force of Climate-related Financial Disclosures[1] published in 2017 have become a reference point for engagement on climate issues and more broadly on ESG issues.

Shareholder proposal patterns. The way shareholders have been setting their asks over the years shows a distinct pattern, with significant implications for energy companies and their positioning in the transition to a low-carbon economy. Shareholders' motions have indeed progressively stepped up in ambition, moving from a required disclosure of climate risks to then more strategic asks, in the form of the adoption of emission reduction targets consistent with the Paris Agreement goals, the provision of executives' remuneration tied to these targets, or governance structure. In 2019, climate resolutions asking for emissions reductions were filed against, among others, Chevron Corporation and Exxon Mobil, both companies having already agreed and published a report on the impact of climate change.

The expectation of increasing pressure from investors through the use of voting rights has also contributed to companies anticipating shareholders' concerns and addressing them through different channels outside proxy statements, which has coincided with a rise in the direct engagement between investors and companies. This increasing level of companies' responsiveness has concurrently contributed to a decline in the overall level of shareholders proposals submitted.

Expansion to non-energy industries. In conjunction with energy companies' increased action and growing public mobilization, shareholders have also started targeting other sectors such as consumer services and industrials (*Figure 3*), calling on greater transparency on the environmental impact of their supply chains. Companies targeted in 2019 include consumer services giants Amazon and Netflix, tech companies Apple, Facebook and Charter Communications, retailers Ross Stores and Urban Outfitters, and manufacturers Emerson Electric and Transdigm Group.

Figure 3: Climate-related Proposals By Sector 2015 - 2019 (%)



Source: IHS Markit

[1] Task Force on Climate-related Financial Disclosures, https://www.fsb-tcfd.org/about/

Data from proxy statements show that there is growing momentum behind the climate movement and activism can be a powerful tool. Although data refer only to US-listed companies, this is a global trend, which has already had important implications in other regions too. In Europe, oil and gas majors *Equinor* and *Shell* have been under pressure to set emission reduction targets, with the latter agreeing to reduce the carbon footprint in its operations as well as its products (scope 3 emissions).

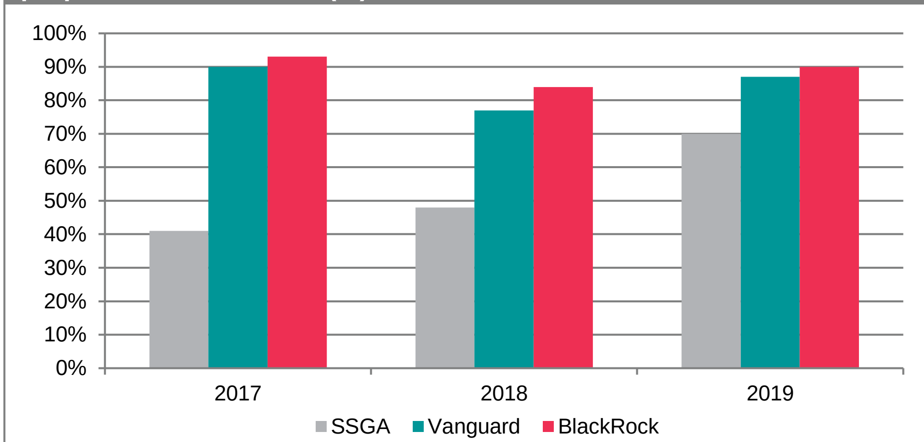
The *Climate Action 100+* initiative, an investor-led coalition for a company representing $32 trillion in assets under management, has contributed significantly in mainstreaming investor engagement on climate action globally. In 2019, for instance, investors acting as part of the initiative co-filed a climate resolution against BP which resulted in the largest ever shareholders backing (investors owning equivalent to 10% of BP or a $12 billion stake in the company backed the filing). Over 99% of shareholders then voted in support of the resolution for the adoption of a business strategy in line with the goals of the Paris Agreement.

Shareholder Support for Environmental Proposals

Looking across the shareholder base, most companies can identify who their holders are, but given the diverse responses to environmental proposals, it's worth looking at each shareholder and knowing their background. (As you may know, US mutual fund managers disclose their voting on every proposal on Form N-PX once per year – meaning we have the tools needed to evaluate much of the shareholder base's support today).

Passive investors. For most public companies, a glance down your shareholder base will reveal a few takeaways with respect to estimating investor support. First – be aware that the major passive investors (*Vanguard*, *BlackRock*, *State Street*) are not automatically in management's corner with respect to environmental proposals (*Figure 4*). They're likely to be top 5 investors in every public company – but aren't always in your corner. Despite supporting management 90% of the time in 2019, *BlackRock* voted with the proponent and against *Starbucks, Ross Stores, and Flowserve* management with its full voting position this year.

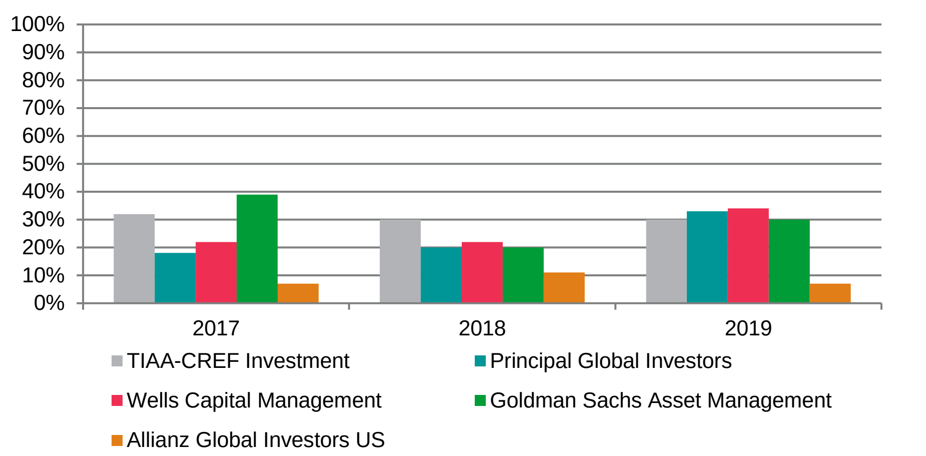
Figure 4: Major passives' management support level on environmental proposals, 2017 - 2019 (%)



Source: IHS Markit

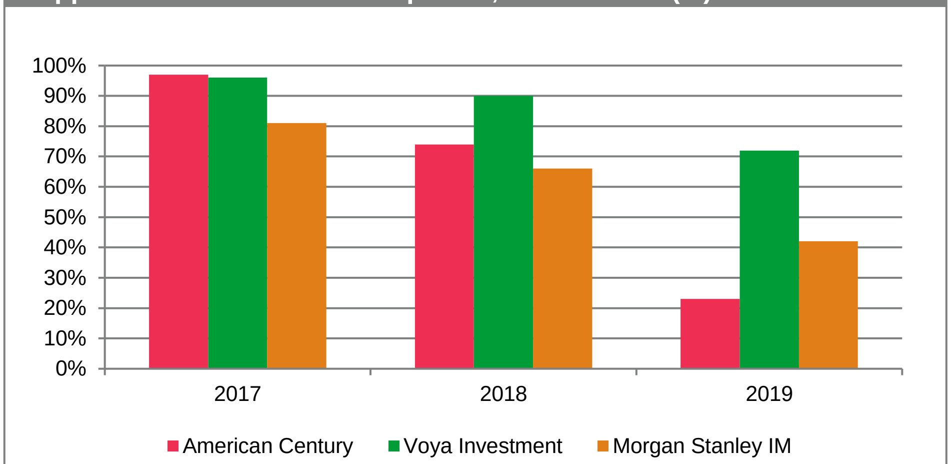
Active investors. The default voting assumption for most active investors is naturally to support management; after all, any active holder that holds a deep-seated belief that management is doing something wrong is not likely to remain a shareholder. Also, given their nature, the vast majority of investors will treat environmental proposals as a "case-by-case" decision in their disclosed voting guidelines. However, there are a number of investors that will consistently express opposition to management in the environmental space that stand out year after year, and are worth noting as you evaluate your shareholder roster. *Figure 5* covers some major names such as *TIAA-CREF* and *Wells Capital* that tend to support proponents based on their fund voting disclosures.

Figure 5: Selected Investors with Low Level of Management Support on Environmental Proposals, 2017 - 2019 (%)



We also see a range of shareholders that have trended towards *increased* proponent support (with three major investors shown in *Figure 6)*. *American Century Investment Management* notes in its voting principles that "*in general, fund shares will be voted in accordance with management's recommendation concerning social and environmental proposals; if, however, the adviser believes that a social or environmental proposal is well targeted and has a rational linkage to maximize long-term risk-adjusted returns if approved, fund shares may be voted in favor*." Apparently, this year, American Century's ESG team found plenty of proposals that met that criteria.

Figure 6: Selected Investors with Decreasing Level of Management Support on Environmental Proposals, 2017 - 2019 (%)



2020

Where does this leave us for 2020? We'll go out on a limb and suggest that this proposal season, with heightened interest in climate and GHG emissions from investor groups across the globe along with the possibility of no SEC no action "safety net", will generate more *dialogue* between shareholders and companies. However, there's no guarantee it will increase the total number of proposals that see the public light of day. With the groundswell of companies disclosing emissions levels or publishing sustainability reports, the remainder that *aren't* disclosing may still be targets for purely disclosure-based proposals, but there are fewer and fewer targets available. Formulating a proposal to push a company to make operational changes is naturally more difficult and can fall more closely within the "ordinary course of business" exemption…but, without a guaranteed SEC backstop, there's a chance we'll see *more* of these proponents approach companies.

Either way, for companies, the best defense has always been a good offense – the time period *prior to* proxy season is the best time to communicate with shareholder voting decision-makers, who have less immediate votes to tend to. If you've faced proposals before, there's no issue with asking the investor how they evaluate similar proposals, and if you expect proponents to approach you in 2020, ask them for their thoughts on environmental proposals in advance.

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