The Shareholder Commons

BETA STEWARD: THE SHAREHOLDER COMMONS VOTING GUIDE

March 17, 2021

Welcome to the inaugural edition of TSC's guide to voting as a beta steward!

As the 2021 proxy season begins to heat up, developments on proxy voting around the world will emerge every day. We're starting a separate, weekly digest to keep you informed of upcoming votes that lend themselves to a systems-first investing lens, and will only provide brief synopses here in our monthly newsletter. **Please follow this link to sign up for Beta Steward and stay on top of this proxy season.**

Let's start by establishing what we mean by beta stewardship.

Pension funds and other asset owners must preserve their capital and earn sufficient return to satisfy obligations to retirees and other liabilities. Asset managers must help investors optimize their returns based on an acceptable level of risk. For owners and managers alike, returns are the result of three variables:

1. The return of the market overall to the classes of securities within a portfolio (beta);

2. The performance of the portfolio above or below beta based on the securities selected to be in the portfolio (alpha); and

3. Asset management costs and fees.

Historically, asset owners and managers have focused on the second and third components and accepted beta as a factor over which they did not have control and for which they had no responsibility. This perspective has become untenable, as irresponsible corporate behaviors pose systematic risks to the economy that will overwhelm any alpha that may be generated through engagement or security selection. Corporate conduct that harms social and environmental systems threatens not just people and planet—but also overall economic performance, a critical determinant of beta.

Beta stewardship is more than ESG integration. While investors and business have begun to address important systemic issues like climate change and racial injustice, almost all of their activity is conducted through the lens of increasing shareholder value at individual companies. While we can all celebrate the ability of corporations to "do well by doing good," it will not be nearly enough to address the systemic risks we face. Beta stewardship insists that companies stop "doing better by doing bad." Investors must sometimes insist that individual companies sacrifice long-term financial return for the good of the economy (and diversified portfolios) overall.

Shareholder stewardship in governance demonstrates that shareholders can indeed affect behavior across industries and corporations through voting and engagement. Thus, if shareholders can analyze the potential effects of their votes on corporate behaviors that affect the economy, they can—for the price of exercising a vote—make market-wide changes to corporate behavior that raise a critical facet of return.

Pending Votes

Here are links to proxy ballots that have been issued with noteworthy proposals, along with those companies' annual meeting dates. You'll find further details in the sections that follow.

- **Bank of America** **(NYSE: BAC)**—April 20, 2021—*become public benefit corporation*
- **Abbott Laboratories** **(NYSE: ABT)**—April 23, 2021—*report on political influence*
- **Eli Lilly** **(NYSE: LLY)**—May 3, 2021—*report on political influence*

TSC-Supported Resolutions

TSC is assisting various shareholder proponents in filing and/or negotiating proposals that either (1) ask companies to convert to benefit corporations, or (2) ask companies to disclose external social and environmental costs of their business practices.

Some of the companies have asked the U.S. Securities and Exchange Commission (SEC) to allow them to exclude the proposals from their proxy statements, attempting to make arguments that the proposals violate the SEC's Rule 14a-8 requirements. In every case so far, the proponents disagree with the companies' assessments, and we are currently helping them to compose and file responses. Here's the running tally.

Externalities Disclosure

Proposals were filed at **McDonald's** and **YUM! Brands** requesting a report on the *external public health costs associated with antimicrobial resistance (AMR) that arises from excessive use of antibiotics in their meat supply chains*. The proposal cites studies that calculate economic losses from AMR at $54 trillion by 2050.

We are delighted to announce that we have reached a significant milestone, with Yum! becoming the first public company to agree explicitly to disclose the impacts of its practices on the global economy and the portfolios of diversified shareholders. You can see the full agreement here, and our press release about the agreement here. McDonald's has declined to discuss a similar agreement and has not sought to exclude the proposal from its proxy, so we expect this resolution to go to a vote at the golden arches.

Proposals at **Goldman Sachs** and **JPMorgan Chase** request that the companies disclose how their *facilitation of multi-class voting, which gives individuals perpetual power over critically important companies like Facebook and Alphabet, will affect the economy and markets over the long term*. Both companies are seeking to exclude the resolutions, arguing that the proposals covered ordinary business matters and were too vague.

We've submitted responses to Goldman Sachs' and JPM's exclusion requests, arguing that the concentration of power in a few minority shareholders is a recipe for disaster and represents a critical policy issue. Ironically, both companies recognize the concern, as each of their asset management businesses has comprehensive voting guidelines opposing the very structures that their underwriting business facilitates. Our responses also contest the companies' assertions of vagueness.

The SEC didn't concur with our arguments regarding the Goldman Sachs proposal, and we are currently composing a request that the SEC reconsider its decision. Recent multi-class IPOs in the United Kingdom and South Korea illustrate the growing danger of a technique that separates diversified investors from control of their investments and threatens to isolate a growing group of founders from accountability for the social and environmental impact of their companies.

A proposal at **PepsiCo** requests a report on the *public health costs of its food and beverage business and how those costs affect market performance*, in light of the fact that the World Health Organization has assessed the unpriced social burdens of obesity at nearly three percent of annual GDP. The company sought to exclude the resolution on the same ordinary business and vagueness grounds as the preceding two companies. We submitted a response to PepsiCo's exclusion request, arguing that publicity around PepsiCo's targeting of Black children in its advertising campaigns and participation in trade groups that block public health legislation demonstrates the importance of the policy issue behind the proposal. The SEC rejected PepsiCo's argument, and this resolution will go to a vote.

A proposal at **Marriott International** requests a report on the *external social costs created by the company's compensation policy and its contribution to growing inequality*. Prior to his death last month, Marriott's CEO received compensation equal to 346 times that of the company's median compensated employee, while its lowest-paid workers don't earn a living wage. His successor will presumably receive a comparable compensation package. The proposal cites research that estimates a 2-4% reduction in GDP from inequality-driven demand reduction.

Marriott is seeking to exclude the resolution on similar ordinary business and vagueness grounds as described above. We have filed a response to Marriott's exclusion request, arguing that publicity surrounding the company's massive worker furloughs in tandem with its pursuit of a raise for its then-CEO and substantial dividend payouts in the middle of the COVID-19 pandemic demonstrates the importance of the public policy issue underpinning the proposal.

Public Benefit Corporation Conversion

Proposals at **BlackRock**, **Caterpillar**, **Salesforce**, **Facebook**, **Alphabet**, **UPS**, **Tractor Supply**, **S&P Global**, **3M**, **Bank of America**, **Goldman Sachs**, **Citigroup**, **Wells Fargo**, and **Chevron** request that the companies *amend or consider amending their certificates of incorporation to become public benefit corporations*, in light of their adoption of the Business Roundtable's Statement on the Purpose of a Corporation (BRT Statement). A similar proposal at Yelp hinges on that company's recent proclamations of its intention to oppose racism and foster "an inclusive culture." The proposals note that the law of the companies' states of incorporation precludes authentic commitment to the stakeholder model acclaimed in the BRT Statement, unless the corporations adopt benefit corporation law.

But the amendment would not just benefit stakeholders. It also provides a better structure for diversified shareholders. Conventional corporation law requires corporations to prioritize the interests of their shareholders, but this company-first approach fails to recognize that an individual company may profit from activity that undermines the social and environmental fabric upon which the vast majority of diversified shareholders depend. Beta stewardship goes hand-in-hand with the PBC structure.

So far, Alphabet is seeking to exclude the proposal, claiming, among other things, that it is not within the company's power to implement and that it would cause the company to violate the law. We have filed a response to Alphabet's request, noting that the SEC long ago rejected arguments that proposals to amend a company's certificate of incorporation are excludable and correcting the company's mischaracterization of its legal obligations.

In contrast, Tractor Supply sought to exclude the proposal on the grounds that it has already been substantially implemented, among other things. We filed a response to Tractor Supply's request, pointing out that without converting to a benefit corporation, the company must prioritize shareholders over stakeholders whenever their interests clash, which precludes any authentic commitment to stakeholder values, which in turn means that the proposal cannot yet have been implemented. The SEC rejected Tractor Supply's argument, and this resolution will go to a vote.

For its part, 3M sought to exclude the proposal on the grounds that it seeks to micromanage the company and deals with ordinary business. We filed a response to 3M's request, demonstrating the significance of the proposal's policy issue by laying out the substantial legislative activity surrounding benefit corporations and explaining how adopting the proposal would *expand* board directors' discretion, which is the opposite of micromanagement. The SEC rejected 3M's argument, and this resolution will go to a vote.

Market Materiality Disclosure

Finally, a proposal at **State Street** requests a report on *how the company's voting and engagement policies, which only consider individual corporation materiality and exclude capital markets materiality, affect its clients and shareholders*, the majority of whom are diversified investors. This proposal essentially asks a universal owner to account for the costs of not acting like one. State Street is seeking to exclude the resolution on the internally inconsistent grounds that:

1. The proposal can't be understood;
2. The proposal can be understood well enough to know that it would be illegal to implement; and
3. State Street has already implemented the purportedly illegal proposal.

One might wonder how State Street squares these points—its no-action request makes for some interesting reading. We've filed a response to State Street's exclusion request, deconstructing the company's contradictory tangle of arguments.

Other Shareholder Resolutions for Beta Stewards

Adding Systemic Effects to the Voting Calculus

Beyond proposals aimed directly at beta stewardship, many matters that will come to a vote this season will implicate the systems-first approach that a diversified shareholder must consider in order to optimize returns. In considering how to vote on proposals and other matters, shareholders should, in addition to weighing the vote's effect on a single company, consider the system-wide costs and risks of social and environmental impacts. Among other matters, such votes may address:

- disclosure of the external costs of company activity;
- compensation that fails to address such risks and costs; and
- the systemic effects of political influence.

Here are some examples of pending shareholder resolutions for which proxy statements have been mailed. We will update this list as the season proceeds.

Political Influence Disclosure

Proposals at **Abbott Laboratories** and **Eli Lilly** ask the companies to disclose more details about their lobbying and political influence activities. The proposals are framed in terms of risk to individual company value, which we would argue is the inverse of a beta stewardship approach, which would instead contemplate the costs corporate behavior imposes on wider systems. Nevertheless, corporate capture of the political process constitutes a serious barrier to beta stewardship, and this proposal points out the disjuncture between, for example, Abbott's public positions on neonatal health and Eli Lilly's public positions on affordable medicine and their respective political influence activities concerning those subjects. TSC recommends that you vote in favor of these resolutions.

For more information on these initiatives, be sure to check out our Beta Stewardship platform. If you know of a shareholder resolution anywhere in the world that you think presents an opportunity to vote as a beta steward, please send details to sara@theshareholdercommons.com.

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