

# LIGHTHOUSE

SEPTEMBER 2022 | NORTH AMERICA EDITION

M O R R O W S O D A L I

## IN THIS ISSUE

- Shareholder proposal review
- ESG Q&A with Morrow Sodali's Greg Reppucci
- Hasbro's proxy contest win over Alta Fox
- The universal proxy card
- Managing shareholder expectations on treasury-based equity plans: how not to get burned
- Get to know Morrow Sodali – Interview with Director of Debt Services, Pia Gowland



# 06



## CONTENTS

### 01 SHAREHOLDER PROPOSAL REVIEW

We review the 2022 proxy season shareholder proposals, highlighting proposals of note, including some new proposals in the environmental and social space.

### 06 ESG Q&A

In this ESG Q&A, we speak with Morrow Sodali's Greg Reppucci, Senior Director - Sustainability and Corporate Governance, about trends from the latest proxy season and what to expect as we head into 2023

### 10 HASBRO'S PROXY CONTEST WIN OVER ALTA FOX

In this case study, we review Hasbro's defense against shareholder activist, Alta Fox, in a contested director election where Morrow Sodali acted as a strategic advisor

### 12 THE UNIVERSAL PROXY CARD

In this article, we discuss the SEC's amended the proxy rules that require the use of Universal Proxy Cards (UPC) for both management and shareholders soliciting proxy votes for their own candidates in contested director elections

### 14 MANAGING SHAREHOLDER EXPECTATIONS ON TREASURY-BASED EQUITY PLANS: HOW NOT TO GET BURNED

In this article, Morrow Sodali Canada's Jackie Cheung, explores strategies to manage shareholder expectations and mitigate risks of a failed resolution on treasury-settled equity plans for Canadian issuers

### 26 GET TO KNOW MORROW SODALI

Q&A with Pia Gowland, Director, Debt Services, Morrow Sodali.

# 10



# 12



# 2022 PROXY SEASON – SHAREHOLDER PROPOSAL REVIEW

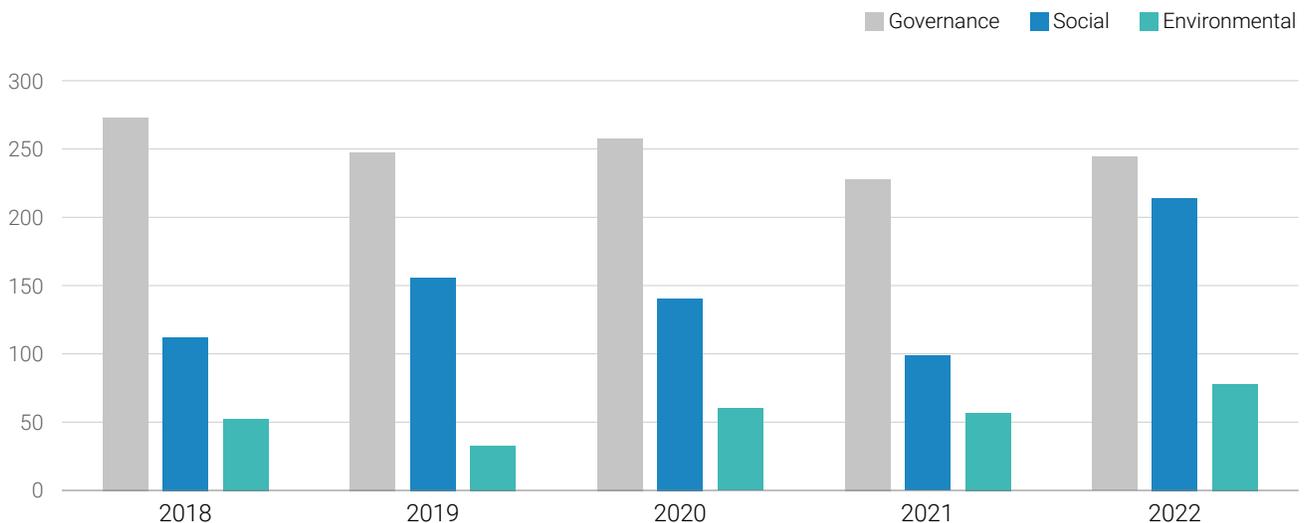
In late 2021 the SEC announced that it would take a new approach to the economic relevance and ordinary business exemptions through the no-action process. This led to the SEC allowing fewer shareholder proposals to be omitted by issuers, and the first half of 2022 saw a significant increase in shareholder proposals that went to a vote.

A total of 538 shareholder proposals reached a vote in the first half of 2022. This is a significant increase from 385 in the first half of 2021. Of note, this increase in volume did not coincide with an increase in the number of proposals that received a majority vote. In 2021, 76 proposals received a majority vote, compared to 73 in 2022.

Governance, social and environmental proposals all increased in volume in 2022. Most notably, social proposals increased from 99 to 215 year over year, making up 39% of all shareholder proposals. Governance proposals made up just under half of the total shareholder proposals, which is a drop from 59% in 2021. Environmental proposals made up approximately 15% of all shareholder proposals in both 2021 and 2022.

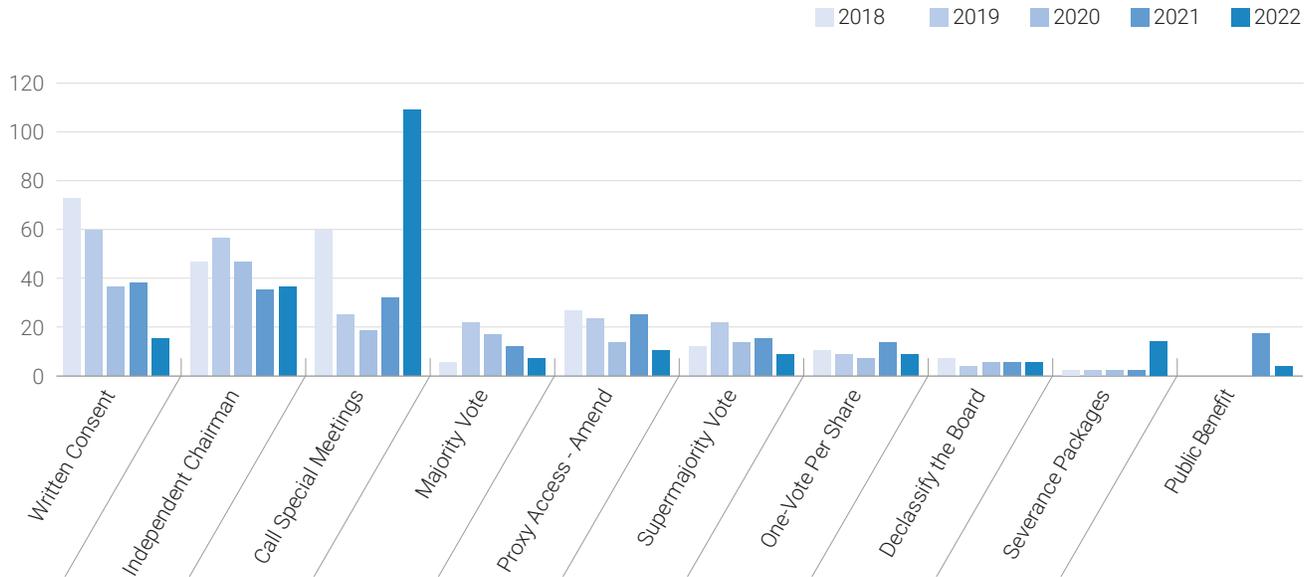
Due to the change in the SEC stance on no-action letters, 2022 reversed the trend of fewer shareholder proposals going to a vote in 2021 than in 2020. 2022 is the highwater mark for shareholder proposals going to a vote, in large part due to the SEC’s decision.

## TOTAL SHAREHOLDER PROPOSALS 2018-2022



Below we look at some of the more popular proposals. Numbers and percentages are based on Russell 3000 companies unless otherwise noted.

## GOVERNANCE PROPOSALS



### Severance Packages

Proposals requesting that director severance agreements come to a shareholder vote increased significantly year over year. So far this year, 14 proposals appeared on ballots. This is a major jump from 2021, when only one proposal appeared. This proposal has only passed once in the preceding five years but, passed four times already in 2022. The companies where the proposal passed this year are **Fiserv, Inc. (FISV)**, **Alaska Air Group, Inc. (ALK)**, **AbbVie Inc. (ABBV)** and **Spirit AeroSystems Holdings, Inc. (SPR)**.

### Call Special Meeting

The shareholder right to call a special meeting appeared as a voting item on 108 ballots in 2022, a notable increase from 32 in 2021. Average support also increased year over year from 32.23% in 2021 to 36.57% in 2022 of votes cast FOR. This proposal received a majority of votes in favor four times in 2021 and nine times in 2022.

### Written Consent

The number of proposals related to shareholders' right to act by written consent dropped significantly year over year. In 2021, a total of 72 proposals appeared, 11 of which passed. This year, six proposals were voted on and only one passed.

Support for written consent proposals also dropped year over year, as the average FOR vote decreased from 40.38% in 2021, to 34.55% in 2022.

### Allow Virtual Attendance at all Shareholder Meetings

A proposal to allow virtual attendance at annual and special meetings appeared for the first time in 2022 at **Jack in the Box Inc. (JACK)**. JACK made no recommendation with regards to the proposal and it passed with 69% of the vote in favor. This proposal specifically requested amendments to the company's governing documents to "ensure that moving forward, its annual and special shareholder meetings will be held either in whole or in part through virtual means (i.e., webcast or other on-line system) and that virtual attendance be allowed." This proposal was intended to bolster shareholder accessibility to company shareholder meetings.

### Adopt Simple Majority Vote

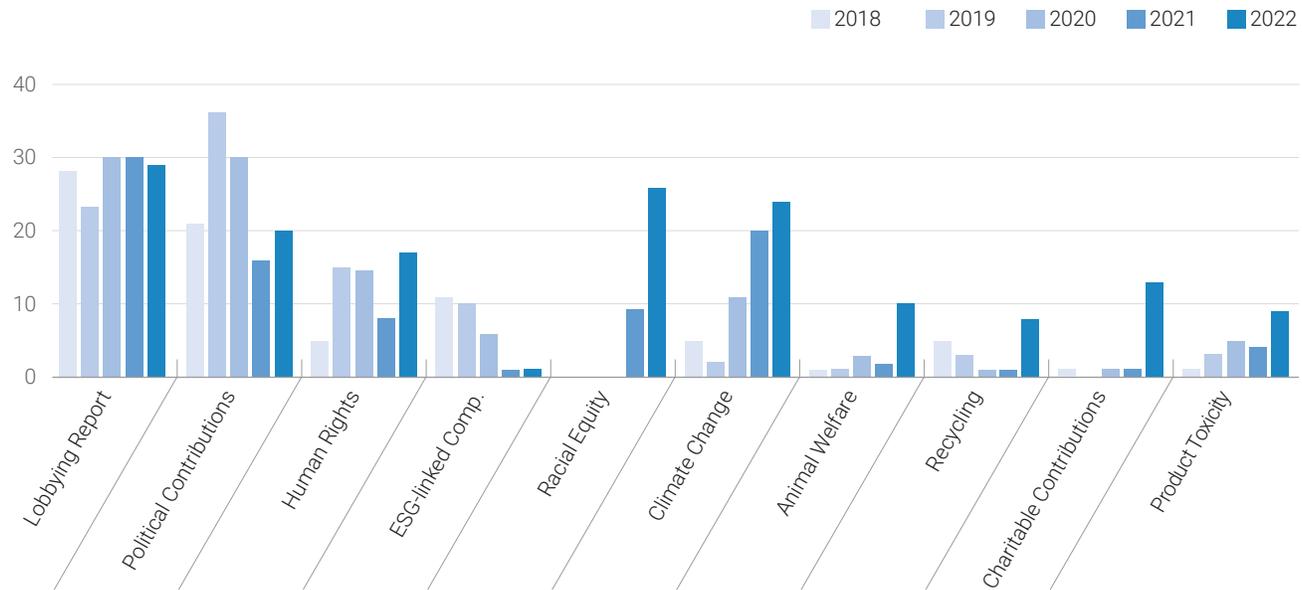
Proposals to adopt simple majority voting for directors were neither as popular nor as supported year over year. In 2021, six of these proposals reached the ballot, all of which passed with high returns of shareholder votes in favor – average FOR vote around 91.32%. In 2022, only

two proposals made it to ballot, one of which passed at **Netflix, Inc. (NFLX)** with 58.40% votes in favor. The other proposal failed at **Vertex Energy, Inc. (VTNR)** and only received 16.9% of votes in favor. This year’s results were more in line with that of 2020, when two of three simple majority proposals failed, and average support was 36.10% of votes cast in favor.

**Public Benefit Companies**

The 2021 proxy season was the first time Public Benefit Corporation proposals appeared, reaching a vote sixteen times. Shareholders opposed these proposals, as all sixteen failed - the average FOR vote only at 3.43%. After low voting support last year, the volume of these proposals dropped significantly, to a total of three in 2022. The percentage of votes cast FOR remained in the single digits this year, at a 2.13% average.

ENVIRONMENTAL AND SOCIAL PROPOSALS



**Animal Welfare**

Eight proposals relating to animal welfare took place in 2022, none of which passed and average support was 15.95%. Despite the poor turnout, both the number of proposals and average FOR vote trended up year over year. In 2021, only two animal welfare proposals made it to a vote. Both failed and averaged 7.45% of votes cast in favor.

**Report on EEO**

Five proposals requesting reports on the effectiveness of diversity, equity and inclusion metrics appeared in 2022. Each of the five failed to receive a majority of votes cast in favor, and the average vote in favor was 34.88%. This is a decline

from 2021, when ten proposals appeared and received far more shareholder support. Of the ten last year, five passed and the average support was 58.24%.

**Racial Equity**

Both the volume and support of proposals calling for racial equity and/or civil rights audits trended up year over year. In 2021, nine proposals reached a vote and all failed to receive majority support. So far in 2022, nine of twenty-six proposals passed, averaging 44.14% of votes in favor. Examples of the companies where racial equity and civil rights proposals passed in 2022 include **Apple Inc. (AAPL)**, **Johnson & Johnson (JNJ)**, **The Home Depot, Inc. (HD)**, and **McDonald’s Corporation (MCD)**.

### Report on Climate Change

Shareholder support for climate change proposals declined year over year. Last year, eight of 17 proposals received majority support and in 2022, 23 proposals were voted on and only four passed. The average vote in favor dropped from 52.64% to 31.25%.

### GHG Emissions

Twenty-four proposals related to greenhouse gas emissions came to a shareholder vote in 2022. This is a major increase from five in 2021, of which four passed and received an average FOR vote of 74.58%. The success rate of GHG proposals did not carry over to 2022, as only seven of the 24 total passed, though, as noted, many more proposals came to a vote in 2022. The average FOR vote in 2022 was 41.94%.

### Political Lobbying and Contributions

Both political lobbying and political contributions proposals remained popular ballot items in 2022. A total of 29 lobbying proposals appeared in 2022, only two of which passed. Political disclosure proposals appeared on 20 ballots in 2022, and again only two passed.

Average support for both lobbying and political contributions proposals waned year over year. In 2022, the average vote FOR lobbying proposals was 34.60%, down from 36.73% in 2021. Political contributions proposals had an average FOR vote of 30.34% in 2022 and in 2021 the average vote FOR was 40.16%.

### Human Rights

Proposals calling for reports on human rights practices increased year over year, from six in 2021 to 16 in 2022. Despite this increase, the number of proposals receiving majority vote did not change – only one each year. Average percentage of votes cast FOR in 2022 was 28.43%. This is a slight decrease from 34.80% votes cast FOR in 2021.

### Tobacco Products

In 2022, a proposal was put forth requesting a company phase out the sale of tobacco products. This is the first time a proposal of this nature has come to a vote. The proponent

was a shareholder of **Philip Morris International (PMI)**. The proposal requests that PMI initiate a plan to terminate the sale of addictive products by 2025. Management of PMI recommended a vote against this proposal, stating that a plan of this scope would require significant government and industry involvement. Shareholders also largely opposed this proposal – which received only 1.50% of votes cast in favor.

Separately, the 2022 proxy season also saw a proposal requesting the preparation of a tobacco related report. This proposal took place at **Walgreens Boots Alliance (WBA)**. This proposal is quite rare, only appearing three other times in the past decade. None of the four received a majority vote and only averaged 23.93% of votes in favor.

### Charitable Contributions

The volume of proposals regarding charitable contributions reports increased year over year - voted on 13 times so far in 2022 versus only once in 2021. The resolution for charitable contributions proposals typically asks the company to report on who they donate to and how much. Shareholders have opposed this proposal significantly – all 13 so far this year have failed and have received less than 10% of votes cast in favor.

### Link Executive Pay to Social Criteria

Over the past several years, proposals requesting companies incorporate ESG metrics into executive compensation programs have been popular. From 2015 to 2021, this proposal appeared a total of 56 times, appearing on between five to 11 proxies a year. Shareholders have consistently opposed this proposal, as it has failed to receive a majority of votes in favor any of the 56 instances during this period. Perhaps related to this lack of support, this proposal only appeared once in 2022, and again failed, only receiving 14.8% of votes cast in favor.

### Product Toxicity and Safety (reports on public health)

Nine proposals requesting companies report on product toxicity and safety have appeared so far in 2022. Most of these proposals requested that companies issue reports on external public health costs. However, some specifically request reports on items such as pesticide or antibiotic use



in a company's supply chain. Proposals this year have been met with opposition from shareholders, as all nine have failed to garner majority support. The average FOR vote in 2022 is 14.62%.

### **Recycling (plastic use/pollution)**

The volume of recycling-related proposals increased year over year, after only appearing once per year in both 2020 and 2021. So far in 2022, eight proposals have been brought forth, mostly calling for reports on plastic pollution and reduction. However, two proposals were instead specific to sustainable packaging – one of which passed at **Jack in the Box, Inc. (JACK)**. All other proposals in 2022 failed to reach a majority of votes in favor. However, it is worth noting that the average vote in favor was relatively high at 45.89%.

As the SEC took a new approach to the no action process, shareholder proponents had much more success in 2022 when it came to having their proposals reach a vote.

Average support for governance proposals generally remained in line with 2021 but average support for environmental and social proposals decreased from the mid-thirties to the high twenties. In fact, certain proposals that were popular and highly supported last year received much lower average support in 2022. The lower average support isn't necessarily unexpected since many of the proposals had a significant increase in volume.

Looking forward, shareholders will take stock of the successes and failures of this year's proposals when considering which proposals to submit in 2023. Next year, not surprisingly, we would expect proposals that were significantly supported to continue to be proposed by shareholders and proposals that were not strongly supported by shareholders are likely to be avoided by proponents. With the change in SEC stance on the no-action process, and the continued concern of investors regarding E&S issues, it will be interesting to see what new proposals may be offered for the 2023 proxy season.

# ESG Q&A

Jennifer Carberry, Director of Marketing – US, spoke with Greg Reppucci, Senior Director of Sustainability and member of Morrow Sodali’s Corporate Governance Consulting Group, about ESG trends and developments over the past year

## On the environmental and social front, can you summarize this past proxy season and what were some of the key takeaways this year?

As has been shared before, this year was a record year for the number of shareholder proposals that went to vote at companies; the number submitted relative to previous years is notable. While we did see several additional governance-focused shareholder proposals go to vote this year, not surprisingly we saw a significant increase in the number of environmental and social shareholder proposals go to vote this year.

The increase in proposals was a combination of factors: the success of many proposals in 2021 encouraged proponents to not only submit similar proposals to additional issuers this year, but also encouraged proponents to continue to refine their proposals further for more nuances in an effort to push companies further on environmental and social initiatives. In addition, the Securities and Exchange Commission’s (SEC) revision on No Action Relief also played a factor in the total

number of proposals going to vote, as certain proposals that would have likely received No Action Relief in previous years did not receive the same benefit this year.

All said, despite seeing this increase, there was a general decline in the average level of support for environmental and social shareholder proposals in particular, which seems to have been a result of the factors discussed above.

## So were proposals different this year than last?

We definitely saw a good portion of proposals this year that were carry overs from last year, although several of these pushed into additional industries – perhaps at a more rapid rate than we have seen previously. Some of the carry over proposals that were prominent this year included proposals related to values-aligned political contributions, climate-related reports and racial equity / civil rights audits. Racial equity / civil rights audits were particularly of focus this year, as these proposals seemed to reach multiple industries.



“... when we think about these pending rules, ultimately it is essential for the board and management to be in sync in terms of understanding how their companies are addressing these issues.”

We also saw a number of new proposals this year that pushed for more action from companies in a more nuanced or prescriptive fashion, including proposals that requested companies to adopt policies not to fund or underwrite new fossil fuel initiatives or other environmental or social topics, requested reports or action on targets related to Scope 3 emissions, and several that requested reports on costs and impacts of certain issues on shareholder returns. These proposals, as well as several other proposals, appeared too limiting or restrictive for many shareholders.

**And how were these proposals assessed this year and what were some of the key takeaways from the results?**

If we look at just the full outcome of shareholder proposals this year, relative to last year, we see there was a decrease in the average level of support on environmental and social topics as mentioned before. We did see a notable increase in the level of support for racial equity / civil rights audits, though most other topics – on whole – generally declined in the level of support relative to 2021. That said, if we look at the proposals further, I think we see that voting for proposals of similar caliber was generally consistent with the prior year. The decline appeared to primarily be driven by new proposals being more prescriptive and/or nuanced – requesting companies to take specific actions that previously were not requested of – or similarly were driven by submissions of proposals at companies that had already taken significant action on the topic of focus.

Some of the newer proposals that I mentioned above did not fare as well as proponents were likely hoping for; several of which averaged support of less than 20 percent.

**The SEC has had a number of proposals out this year that will have an impact on environmental and social topics. What are your thoughts?**

There are a handful of proposals being considered that will have an impact on issuers in the coming years. The first one that comes to mind is one that is perhaps more straightforward – the SEC’s proposed revisions to several definitions associated with No Action Relief. When shareholder proposals are submitted, issuers can request the SEC grant omission of the proposal from a company’s proxy statement and annual meeting if the SEC determines the proposal obstructs the company’s day-to-day operations (e.g., is over-prescriptive or “micromanages”) or if the proposal does not have significant social or ethical societal impacts. If implemented, the newly proposed revisions will make it more difficult for issuers to receive No Action Relief and, as a result, we may see several additional – and perhaps underwhelming – proposals go to vote this year. While it is unclear how these revisions will impact voting results, the marketplace will ultimately be responsible for determining if proposals have been implemented by issuers or not.

Another topic that we anticipate the SEC proposing rule revisions to is regarding human capital management. In November 2020, the SEC implemented a principles-based rule for disclosure of human capital management in the form 10-K which resulted in issuers adding some additional information on their workforces. The SEC is likely to revise this further and issuers should likely anticipate more structure from the SEC in terms of the type of information that may be required in a 10-K filing – including disclosure of certain metrics.

One proposal that has received significant focus is the SEC’s pending new climate disclosure rules, which will have a marketable impact on issuers’ disclosure of climate-related information. While the rule generally is based off of the

Task Force on Climate-related Financial Disclosure (TCFD) recommendations, which institutions are already requesting issuers to disclose in alignment to, there are several additional nuances that the proposed rule has that will require additional information from issuers. Notably, the proposal is currently written to require climate disclosure to be incorporated into the 10-K, which will have an impact on the timing of the climate disclosure for nearly every public company.

We've also seen the cybersecurity rules proposal related to additional disclosure on cyber-related events, as well as the role of the board's oversight on cyber-related issues. These requirements will not only likely have an impact on the level of disclosure issuers currently provide on risk management, but the expected timing of some of the disclosures similarly may be of concern for issuers – particularly if there are ongoing investigations associated with a cyber-related incident.

When we think about these pending rules, ultimately it is essential for the board and management to be in sync in terms of understanding how their companies are addressing these issues. Strong narratives around a company's approach to addressing each topic, and further how the board oversees these topics, will be critical. Especially as we wait for these rules to be finalized and implemented, companies have significant opportunity today to develop, implement, and be prepared to articulate on, a clear strategy.

### **What are some of the key takeaways for the SEC's pending climate rule?**

For the climate proposal, there are two things that companies should take into consideration. One, the marketplace is pushing for climate disclosure, and while we can debate the details or the requirements of the SEC's rule, the market really has been asking for detailed disclosure around climate for the last couple of years – and we should anticipate more pressure for strong disclosure going forward. If companies haven't already done so, it is very important to begin to develop and strengthen climate disclosure, understand what the company's emissions footprint looks like, understand

how climate should be part of its risk assessment, and understand where the company may be vulnerable in the future as a result of climate related incidents.

The second part to keep in mind is that if this rule goes into effect as drafted, the rule will require companies to disclose climate information on an accelerated timeline. Today, companies typically disclose this information at minimum several weeks but often several months after their 10-K filings, whereas the proposed rule would require disclosures not only be provided on a shorter time frame, but also be provided in parallel with financial disclosures. The accelerated timeline will require companies to revisit their reporting processes and assess their reporting structure, working with the subject matter experts, internal audit and controls to really make sure that the appropriate resources are available so that climate-related information can be reviewed and disclosed in parallel with financial disclosures.

**“... the marketplace is pushing for climate disclosure, and while we can debate the details or the requirements of the SEC's rule, the market really has been asking for detailed disclosure around climate for the last couple of years – and we should anticipate more pressure for strong disclosure going forward.”**

**Going back to the number of environmental and social proposals that were submitted this year, what is it that companies could be doing today to manage the growing focus on these issue, and sustainability more broadly?**

Environmental and social issues, or sustainability more broadly, is top of mind for many today. For companies, it is essential to recognize the importance of managing the issues most relevant to the company. We can see today how these topics transcend across society and into the boardroom and how companies have to be able to navigate the growing pressures for opinions or involvement in issues of societal relevance. Regardless of how a company intends to, or does not intend to, respond to a topic or address an issue, it is very important for the company to have a strong strategy and disclosure foundation for those topics that are most relevant. This way, companies can help guide the narrative back to the efforts that the company has undertaken and can point to how societal issues may or may not be something a company does (or does not) tie back to the company.

**And any additional thoughts for companies?**

On sustainability, I think it is worth reiterating that sustainability is a very collaborative effort, and it requires companies needing to ensure the appropriate people are at the table to analyze, develop, and implement efforts. Making sure we are not siloed and that we are cross-functional is going to be critical to making sure that our progress on these initiatives is indeed beneficial to the company. When we go to focus on how a company engages with shareholders, we really want to make sure that the individuals that are responsible for these efforts are either at the table or preparing those at the table talking to our investors. We have to recognize that those that are engaging with investors are the ones that need to be able to have candid conversations on these issues. If we don't have the appropriate people in the room during those engagements, investors may not fully understand or appreciate a company's story and approach to these topics. Having that cross functionality, that permeable collaboration across the company, will really be important to ensuring this.



**GREG REPPUCCI**

Greg Reppucci is Senior Director of Sustainability and a member of Morrow Sodali's Corporate Governance

Consulting Group. He analyzes companies' environmental and social issues through a governance lens, helping ensure a holistic approach to environmental, social, and governance ("ESG") topics.

Greg provides guidance on best approaches to ESG issues by identifying relevant topic areas for disclosure and advising on different reporting frameworks and standards, responses to stockholder proposals, and preparations for stakeholder engagements. He is a SASB Fundamentals of Sustainability Accounting (FSA) credential holder, is versed in relevant reporting standards and frameworks, and helps structure disclosures to address shareholder and key stakeholder concerns.

Previously, Greg was a member of the Sustainability Office at PepsiCo and focused on the annual development of their sustainability reporting suite. Earlier in his career, Greg was involved in climate and agriculture-related research at Columbia University's Center for Climate Systems Research and the NASA Goddard Institute for Space Studies.



# HASBRO'S PROXY CONTEST WIN OVER ALTA FOX

## A CASE STUDY

### ACTIVISM IN 2022

The first half of 2022 saw an increase in shareholder activism campaigns of roughly 34% compared to the same timeframe in 2021. (126 campaigns vs. 94 campaigns) Perhaps the most notable takeaway from this uptick is the continued trend of first-time activists throwing their hat into the proxy contest arena. Roughly 37% of the campaigns so far in 2022 were run by funds with no previous activism history.

With so many first-time activists making demands at public companies, it should be of no surprise that most of the reported activism campaigns in the U.S. occur in the mid/small-cap company space. Many of these “first-timers” use successful proxy contests at mid/small-cap targets to continue to grow their funds and springboard into campaigns at larger public companies.

### ALTA FOX CAPITAL MANAGEMENT – THE DISSIDENT

When Alta Fox Capital Management approached Hasbro in the late Fall of 2021, they were a relatively small player in the shareholder activism space. In fact, they did not meet the SEC’s 13-F quarterly filing requirements for investment managers with at least \$100 million in equity assets under management. Therefore their equity ownership was not disclosed publicly anywhere which made their holdings a bit of a mystery.

At the time of their initial outreach to Hasbro, Alta Fox had previously launched only one proxy fight, targeting Collectors Universe, a \$250 million enterprise value company, in June 2020. However, they ultimately settled with the company for minority representation and placed two nominees in the boardroom.

## THE CONTEST

Considering Alta Fox's lone previous activism campaign was at Collectors Universe, a company whose business revolves around sports card and memorabilia collecting, it is perhaps unsurprising that their thesis at Hasbro heavily focused on separating the Wizards of the Coast card-game business from the Hasbro umbrella. Alta Fox made it clear in their communications that they were not just investors, but avid Magic: The Gathering game players. While it is often the case that retail shareholders invest in products or brands they love, Alta Fox's affinity for the Wizards gaming product made their contest feel perhaps more personal. Their war cry of "Free the Wizards," became the theme of their campaign, [suggesting that the gaming unit would provide greater value as a standalone entity]. However, as they were speaking with shareholders, Alta Fox apparently learned their platform was not aligning with wider investor interest as they changed the direction of their campaign midstream. In fact, during the span of the proxy contest, Alta Fox changed their platform more than once. They originally nominated five directors, trimmed to three nominees upon filing their definitive proxy statement, and then further cut their slate to one nominee post the release of ISS and Glass Lewis's analyses in a last-ditch effort to gain institutional shareholder support.

## MORROW SODALI'S ROLE

As a long-standing client, Hasbro engaged Morrow Sodali to provide Strategic Stock Surveillance, Shareholder Engagement and Proxy Solicitation services in connection with its defense. Morrow Sodali's first exercise in all proxy contests is to establish the issuer's shareholder profile from both ownership and voting control perspectives. This analysis provides a road map for the various shareholder constituencies, what they have to vote, and how each are influenced by proxy advisors, etc. It is this study that provides a blueprint for how the shareholder engagement and proxy solicitation should be conducted.

In our initial report on trading activity, Morrow Sodali estimated that Alta Fox had accumulated a position of roughly 815,000 shares. At the time of that analysis, trading prices suggested Alta Fox's investment was at least \$82 million dollars. Within

a month of tracking further accumulation, we determined that Alta Fox had amassed a position of 3.1 million shares in common stock and derivatives, or 2.29% of the outstanding shares, with an estimated total value of over \$315 million dollars. A holding of this size seemed implausible given that Alta Fox had previously been under the \$100 million in AUM threshold. However, a position of this size made sense as Alta Fox was moving up from targeting a \$250 million dollar company in its first contest at Collectors Universe to a \$13 billion dollar company in Hasbro. Morrow Sodali's intel on Alta Fox's trading activity was later confirmed by the purchasing schedule included in their definitive proxy statement.

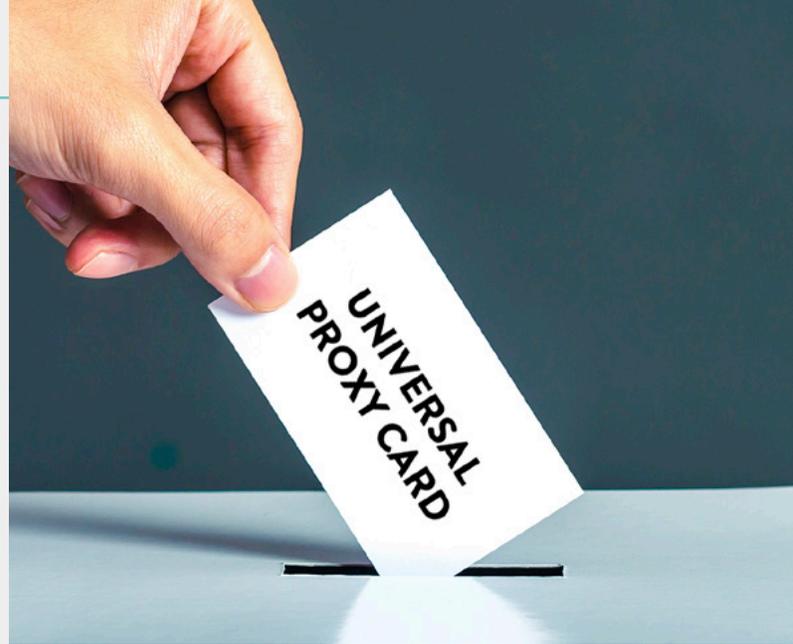
As the proxy contest continued to develop, Morrow Sodali worked closely with the Hasbro IR team to rollout a comprehensive institutional shareholder engagement plan. In proxy contests it is typical for institutions to wait until the ISS and/or Glass Lewis vote recommendations are released before scheduling meetings. This can often create a time crunch as the ISS and Glass Lewis reports tend to be released 10 to 15 days prior to the annual meeting.

The Hasbro shareholder profile has not only a large institutional holder base, but a significant retail component as well. In these situations, it is important to provide shareholders with proxy material that is easy to digest and that ultimately brings them to a call to action – in this case, to vote. Morrow Sodali worked with Hasbro's wider advisory group to canvass the retail shareholder base in an effort to increase the voting return from that category.

## THE FINAL RESULT

With a full effort from the Hasbro board and management team and its advisors, the company secured the voting recommendation of both ISS and GL and all thirteen of Hasbro's incumbent directors were duly elected at the annual meeting, and by a significant margin.

# THE UNIVERSAL PROXY CARD



The Securities and Exchange Commission (SEC) amended the proxy rules to require the use of Universal Proxy Cards (UPC) for both management and shareholders soliciting proxy votes for their own candidates in contested director elections.

## What is The Universal Proxy Card?

The Universal Proxy Rules, for contested director elections, now requires all management and dissident nominees to be included on the proxy cards solicited by each side. This format allows shareholders to support a combination of management and dissident nominees up to the number of eligible seats for election.

## What has changed?

Under the now obsolete system which has been in place for decades, shareholders typically received separate proxy cards from the company and from the activist shareholder with each side's respective nominee(s). Consequently, holders could only easily vote one card, which essentially limited the ability to vote for a mix of nominees from both slates. Shareholders voting by proxy in a contested election had to choose between the company's or dissident's recommended nominees. To vote for a combination of candidates from both slates often required holders to attend the meeting in person and vote by ballot. With all nominees listed on one card, the new universal proxy rules will allow shareholders to vote for a mix of company and dissident candidates without attending the meeting.

## When does the UPC take effect?

Under the new rules, UPCs must be used by both management and the activist shareholders at contested shareholder meetings held after August 31, 2022 conditioned on the activist investor soliciting at least 67% of the outstanding voting power.

## What should companies be prepared for?

According to the SEC's Final Rule on UPC, dissidents will be afforded the opportunity to distribute their proxy materials utilizing the Notice & Access guidelines which can significantly reduce the cost of a campaign and considerably more so at an issuer with a sizeable retail population. A lower cost proxy contest could open doors for first time activists or those with limited budgets who until now may not have had the financial resources to launch an impactful campaign for change in the past. Of note, many activists leverage their public wins when marketing for fresh capital. Further, we may witness the emergence of shareholder interest groups, previously not traditional board composition activists, who may view the rule change as a way to increase their voice on matters related to ESG, diversity, equity and inclusion (DE&I), and employee rights through a formal proxy contest.

## What about “The 67% Solution”?

The activist’s minimum solicitation threshold required under the rule was designed to protect companies worried that UPC potentially exposes registrants to frivolous proxy contests and was increased from a simple majority in the SEC’s proposed rules. While this may be seen as a burden on activists, companies are required to solicit all holders, and activists can take advantage of lower cost mailing methods, e.g. Notice & Access, yet have the benefit of their nominees “free-riding” on the company’s card to all holders.

## Are there any other considerations to be aware of?

The new rules also prohibit companies that have not adopted a true majority vote standard from including an Against voting option on their proxy card because such votes have no legal effect. Companies with a plurality standard must allow only a “For” and “Withhold” option and disclose the treatment, and effect, of a withhold vote in the election.

## How should companies prepare themselves?

- Assemble a team of advisors including legal, financial, PR and proxy solicitation
- Ensure their bylaws are up to date with appropriate provision related to contested elections
- Review board composition, refreshment and governance (ESG is becoming more prominent in proxy contests)
- Consider a complete legal, financial, strategic and governance vulnerability analysis (company, board, and shareholder risk)
- Retain stock surveillance firm to actively monitor trading
- Educate and advise the board of the risks associated with the UPC
- Engage with key shareholders to establish relationship, educate them on company strategy and governance, solicit feedback and maintain an open line of communication
- Create action plan should an activist arise

## How will UPC impact the proxy advisor recommendations?

ISS will still be looking for the activist to make a compelling argument that change is needed on the board before supporting its nominees. However, they have opined that there may be situations where even though they generally support management, they may take advantage of the opportunity to “...for instance, replacing a long-tenured, overboarded director who seems disengaged with a new nominee who brings clearly-relevant skills to the board, or perhaps enhances diversity.” On a positive note, they seem unlikely to support an activist using UPC to weaponize an ESG issue

## Looking ahead to the impact

While the Universal Proxy Card will create advantages to the activist, there will be cases where the opposite is true and we will monitor closely for how it might impact any material changes in board control. Corporate boards could see a higher volume of proxy contests and more directors could be individually targeted. That said, it is critical to have a strategic action plan in place and ready to execute if needed.

The key takeaway is that activist shareholders will now have easier access to a company’s proxy card without the minimum ownership requirements required by a proxy access bylaw. As a result, we expect an increase in board level activism and the continued trend of first-time activist funds looking to make a name for themselves. Companies should begin to strategize now for how the new contested battlefield may look and start reviewing their advance notice provision and bylaws immediately.

## PERSPECTIVES FROM CANADA

# MANAGING SHAREHOLDER EXPECTATIONS ON TREASURY-BASED EQUITY PLANS: HOW NOT TO GET BURNED

BY JACKIE CHEUNG, MANAGING DIRECTOR,  
GOVERNANCE & STRATEGY, MORROW SODALI (CANADA) LTD.

When it comes to executive compensation, we are often asked what issues are top of mind for shareholders and proxy advisors. In the Canadian context, there are two broad categories of compensation proposals that require shareholder approval, (i) Say-on-Pay and (ii) treasury-based equity plan proposals. Many will highlight Say-on-Pay as the beacon of shareholder focus, but equally important to a company's success is reliable access to shareholder approved treasury reserves – reserves which play a critical role in a company's talent and retention strategy.

It is conventional knowledge that companies should take failed Say-on-Pay votes very seriously. Significant resources will usually have to be deployed towards addressing the torrents of shareholder discontent and demonstrating various degrees of shareholder engagement. A failed equity plan, on the other hand, not only signals shareholder consternation towards your compensation strategy, but it also carries with it the very real consequences of a defunct reserve and the inability to further grant awards under a plan that was otherwise available previously – a serious consequence indeed.

Burn rate and dilution are two key concepts that govern equity plan approvals. In the context of equity compensation, burn rate measures the potential dilutive impacts of gross equity grants expressed as a percentage of shares outstanding. Basic dilution, on the other hand, measures the total number of awards outstanding and those available for future issuance under treasury-based compensation plans, expressed as a

percentage of shares outstanding. One then may ask, what burn rate and dilution levels are deemed acceptable by institutional shareholders and proxy advisors? The answer is, you guessed it – it depends. The grant practices and equity plan profile of each company differ on a case-by-case basis. There is not a 'one-size-fits-all' approach when it comes to equity plans and more often than not, companies come to us in a bind when historic burn rates run high and dilution levels are elevated. In this article, we explore strategies to manage shareholder expectations and mitigate risks of a failed resolution when it comes to treasury-settled equity plans for Canadian issuers.

## PROXY ADVISOR ANALYSIS AND RECOMMENDATIONS

Depending on the level of influence of the proxy advisors within a company's shareholder base, Institutional Shareholder Services Inc. ("ISS") and Glass Lewis, & Co., LLC's ("Glass Lewis") recommendations may have significant

impacts on whether or not an issuer’s equity plan receives shareholder approval.

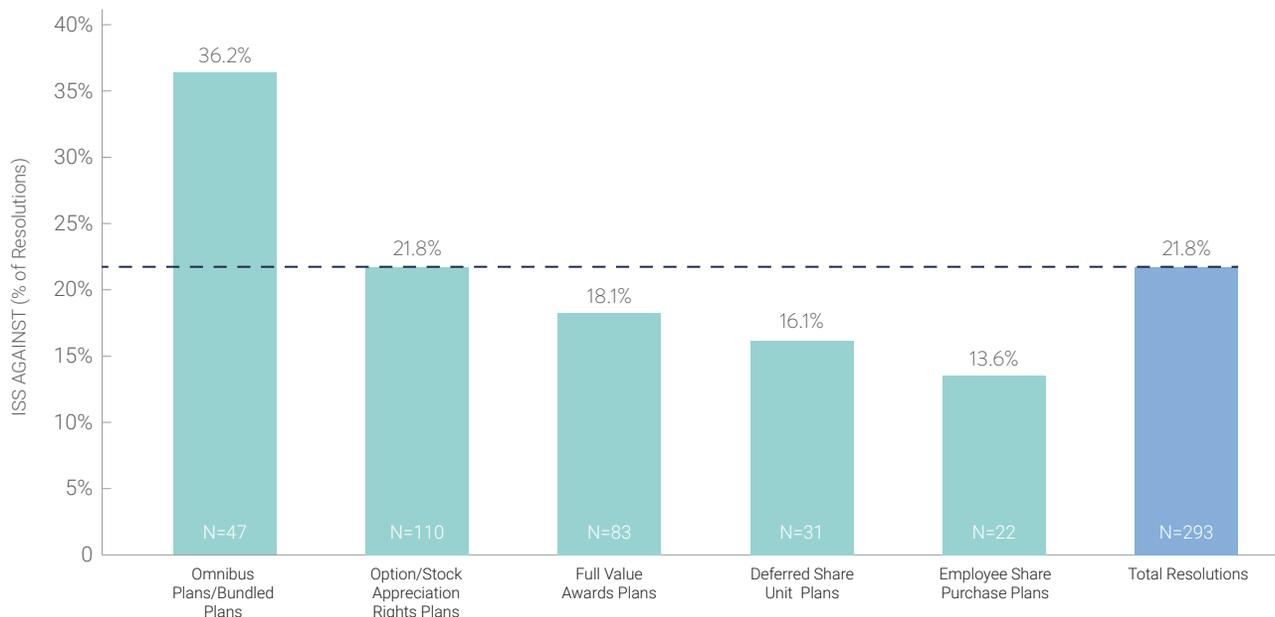
Without diving deep into modelling specifics, we will focus on ISS for the purposes herein. ISS largely relies on its Equity Plan Scorecard (“EPSC”) methodology to assess equity plans for TSX-listed issuers<sup>1</sup>. The EPSC is a pass-fail scorecard which awards points based on three main pillars: (i) plan cost, (ii) plan features, and (iii) granting practices. Issuers who garner 50 points out of 100 will ‘pass’ the EPSC test, and likely receive a positive recommendation absent other overriding factors. While the intent of the EPSC was to place a lesser emphasis on plan cost and Shareholder Value Transfer<sup>2</sup> (“SVT”), factors which historically dominated ISS’ analyses, from experience, more than 60% of points under the EPSC are attributed to plan cost measured via SVT, burn rate, and dilution. Therefore, when putting equity plans up for shareholder approval, a substantial amount of EPSC points will have already been pre-ordained based on a company’s historic grant practices

(burn rate), and the cost of awards that remain outstanding within your reserve (otherwise known as outstanding overhang) contributing to a high SVT.

### ISS RECOMMENDATIONS ON EQUITY PLANS

When looking at proxy advisor recommendations for equity plans, between 2019 and 2022 year-to-date, ISS recommended against 21.8% of all equity plans (293 resolutions) for S&P/TSX Composite Index (“Composite Index”) constituents (Figure 1). While the focus for compensation from an issuer perspective has traditionally been on Say-on-Pay, comparatively speaking, ISS had only recommended against a mere 3.6% of Say-on-Pay proposals for Composite Index issuers<sup>3</sup> versus 21.8% for equity plans. Given that ISS is six times as likely to vote against equity plans as they are for Say-on-Pay, issuers should devote an appropriate amount of resource to planning and preparing for equity plan renewals.

FIGURE 1: ISS AGAINST RECOMMENDATIONS FOR EQUITY PLANS (COMPOSITE INDEX; 2019 - 2022 YTD)



Source: Morrow Sodali Analysis and ISS Corporate Solutions Voting Analytics. As of August 15, 2022.

1. In addition to the EPSC, ISS may also vote against plans based on several overriding factors that they deem to be counter to shareholders’ best interests.  
 2. SVT represents the estimated cost of shares issued under company’s equity incentive plans expressed as a percentage of a company’s market capitalization.  
 3. ISS Corporate Solutions Voting Analytics, August 15, 2022.

It is also to no surprise that we find that Employee Share Purchase Plans (“ESPPs”) and Deferred Share Unit (“DSU”) plans to have the lowest percentage of against recommendations from ISS as they are generally seen as the least contentious (Figure 1). DSU plans for non-executive directors are also generally seen as a form of good governance practice, therefore, they are more supportable from an institutional shareholder perspective absent significant egregious features. However, when plans are bundled or in omnibus form, empirical evidence has shown that it comes with the highest likelihood of an ISS against recommendation (36.2%). From a strategic perspective, we would never recommend combining plans into an omnibus format, despite the perceived benefits for administration, because so long as ISS finds an issue with one of the (several) equity vehicles that are usually available within an omnibus long-term incentive plan, ISS would be forced to recommend against the entire resolution as they have no alternatives to support part of the plan and not another. When plans are discrete, ISS’ traditional stance has always been to evaluate all plans on a combined basis, but support plans individually that fit within their criteria if the plans in aggregate fail their assessment. Therefore, due consideration should be given to keeping plans as separate resolutions whenever possible to garner the highest chances for a positive ISS recommendation.

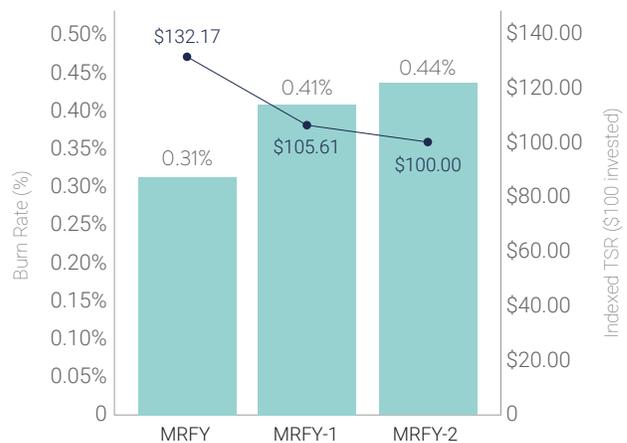
Given an approximate one-in-four chance of a negative ISS recommendation when issuers put forth equity plans for shareholder approval, which companies are at the highest risk and what can issuers do to prepare for what is to come? By looking at the granting practices and dilution levels of Canadian blue-chip issuers, we are able to draw insights on sectoral trends regarding how treasury plans are being used in the Canadian marketplace and the implications that this may have from a shareholder or proxy advisor perspective.

## EQUITY PLAN STATE OF PLAY: A LOOK AT CANADIAN BLUE-CHIP ISSUERS

### Index Median Burn Rate on Decline, Linked with TSR

Based on our research, within the Composite Index<sup>4</sup>, median burn rates<sup>5</sup> have declined steadily over the last three-years indicating a slight regress of treasury-based compensation grants (Figure 2). This reduction is in line with the benchmarked cumulative total shareholder returns (“TSR”) for the Composite Index, which exhibited a slight gain of 5.6% during 2020 and a larger 25.15% gain during 2021 as the markets further recovered from the effects of COVID-19. One explanation for the inverse relationship between TSR and burn rate is that, all else being equal, a higher share price would generally equate to a lower level of burn given grants are usually based on per-unit dollar values of either full value share price or Black-Scholes/ Binomial value for stock options.

FIGURE 2: MEDIAN BURN RATES (COMPOSITE INDEX)



Source: Morrow Sodali Analysis, Management Information Circulars, Audited Financial Statements and Bloomberg Finance LP. As of August 15, 2022. MRFY refers to ‘Most Recent Fiscal Year’, which generally means FY2021. However, companies with early 2022 fiscal year ends may be included in MRFY if such disclosure is made available in their respective 2022 Management Information Circulars.

4. In Canada, the Composite Index represents the “blue-chip” of the Canadian markets. As of August 15, 2022, these are the 238 largest issuers in the Canadian market representing the benchmark index.

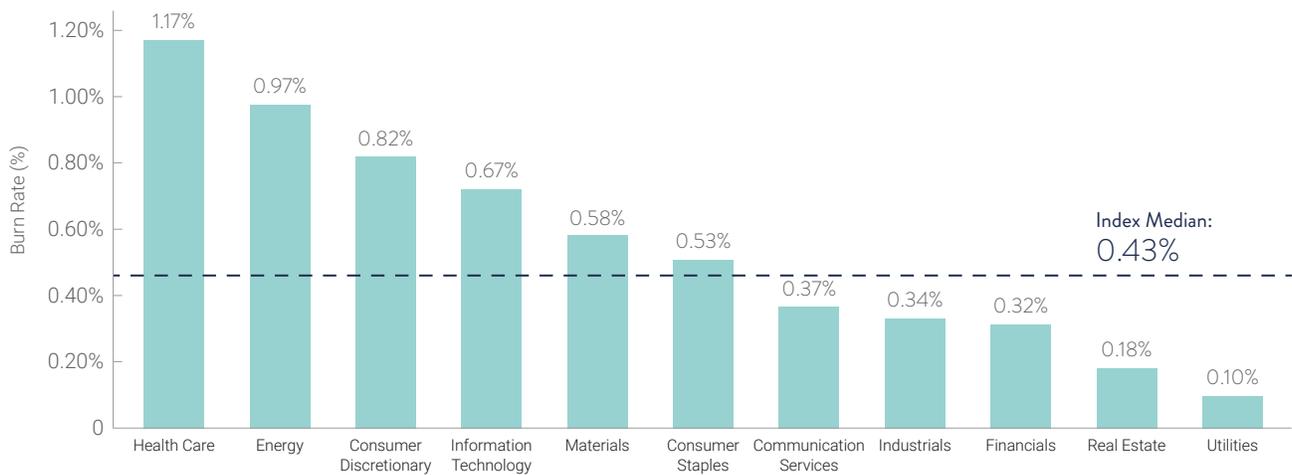
5. Burn rates have been obtained from the review of Management Information Circulars disclosures. In cases where burn rates are not disclosed, burn rates are calculated based on Share-Based Payment disclosures in the Audited Financial Statements. For the purposes of our analysis, burn rate generally refers to the gross grants divided by the weighted average number of shares outstanding.

### High Burn for 'Health Care' and 'Information Technology', Low Burn for 'Utilities'

Over the longer term looking at three-year average burn rates, 'Health Care' companies, which are predominantly Cannabis issuers in Canada, dominate with a median three-year average burn rate of 1.17%, while the 'Utilities Sector' exhibited the lowest burn of 0.10% (Figure 3). 'Energy' trails behind slightly with a 0.97% median three-year average burn rate compared

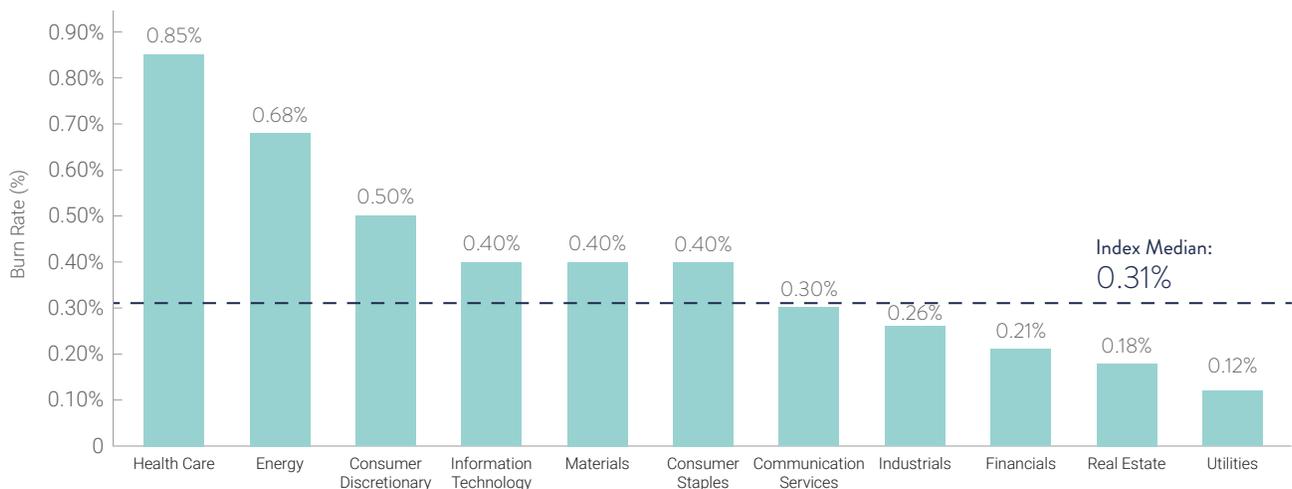
to the Index median of 0.43%. Over the shorter term, based on the most recently completed fiscal year (Figure 4), 'Information Technology' sector companies had the highest burn rate at 0.85%, followed by the 'Energy' sector at 0.68%. 'Utilities' remains the sector with the lowest burn at 0.12% compared to the Index median of 0.31%.

FIGURE 3: THREE-YEAR AVERAGE BURN RATES BY SECTOR (COMPOSITE INDEX, THREE MRFY)



Source: Morrow Sodali Analysis, Management Information Circulars and Audited Financial Statements. Sectors defined by Global Industry Classification Standards. As of August 15, 2022.

FIGURE 4: MOST RECENT FISCAL YEAR MEDIAN BURN RATES BY SECTOR (COMPOSITE INDEX)



Source: Morrow Sodali Analysis, Management Information Circulars and Audited Financial Statements. Sectors defined by Global Industry Classification Standards. As of August 15, 2022.

## Sectoral Changes in Burn Rate Less Linked with TSR

Within specific sectors, as defined by the Global Industry Classification Standards, changes in median and average burn rates have been less tied to TSR (Figure 5). There are many reasons why this may be the case in Canada. First, issuers may opt to either grant equity awards in the year of performance in question, or awards may be granted subsequent to year end for the previous year's performance. This variation would lead to burn rate disclosures lagging the year of the intended grant. Secondly, while the majority of companies have a December 31 year-end and the Most

Recent Fiscal Year ("MRFY") periods generally correspond to a December 31 to December 31 timeframe, a small subsection of companies have year-ends that may differ leading to the inclusion of FY2022 burn rates in some cases in the MRFY figures which would not fully align with the TSR data presented in Figure 5. Finally, treasury awards only represent a portion of long-term incentive award grants as issuers may also rely on cash or open-market settled shares to satisfy equity award obligations. These non-dilutive grants will not be reflected in the data analyzed.

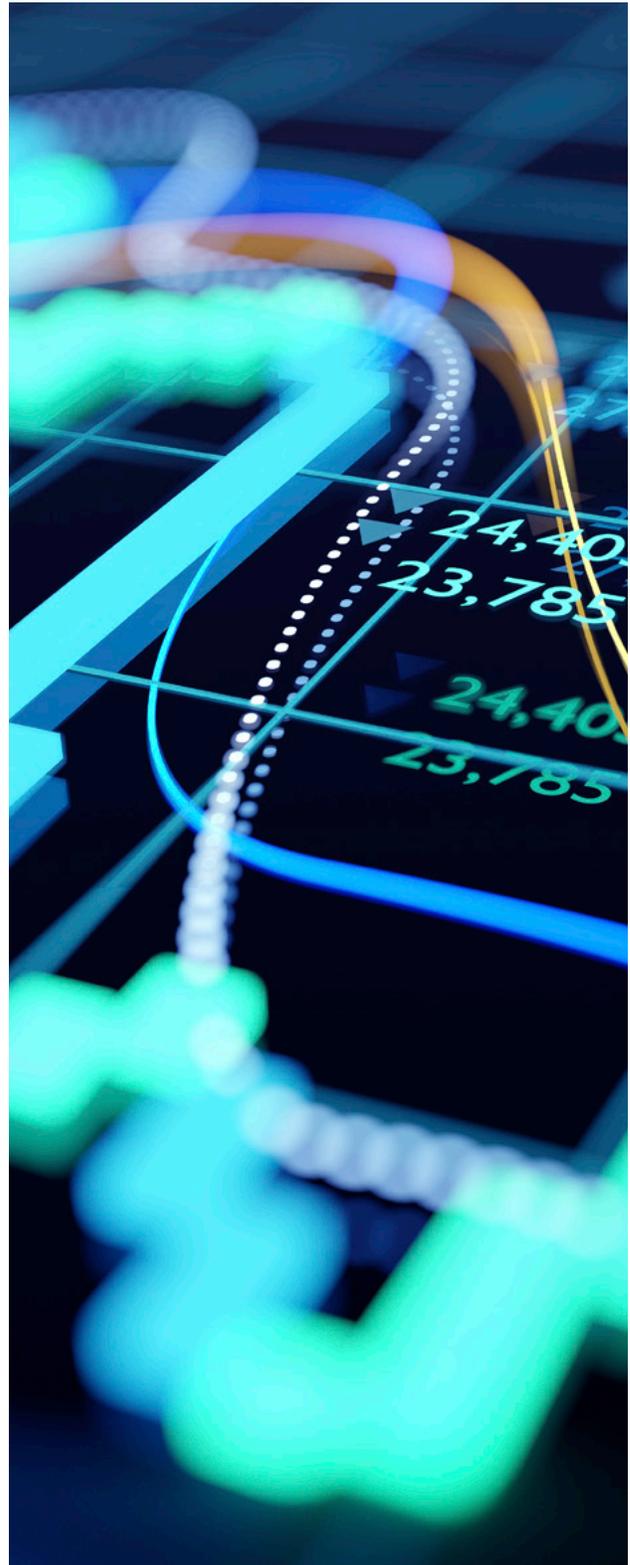
FIGURE 5: THREE-YEAR BURN RATE CHANGES BY SECTOR (COMPOSITE INDEX)

GICS SECTOR	COUNT	AVERAGE BURN RATE			MEDIAN BURN RATE			CUMULATIVE 1-YR TSR		
		MRFY	MRFY-1	MRFY-2	MRFY	MRFY-1	MRFY-2	2021	2020	2019
<b>Communication Services</b> Y/Y Change (%)	7	<b>0.36%</b> -0.12%	<b>0.48%</b> -0.01%	<b>0.49%</b>	<b>0.30%</b> -0.20%	<b>0.50%</b> 0.10%	<b>0.40%</b>	<b>24.7%</b>	<b>-3.7%</b>	<b>13.0%</b>
<b>Consumer Discretionary</b> Y/Y Change (%)	13	<b>0.69%</b> -0.23%	<b>0.91%</b> -0.04%	<b>0.95%</b>	<b>0.40%</b> -0.52%	<b>0.92%</b> 0.32%	<b>0.60%</b>	<b>18.4%</b>	<b>17.0%</b>	<b>15.3%</b>
<b>Consumer Staples</b> Y/Y Change (%)	11	<b>0.66%</b> -0.17%	<b>0.83%</b> -0.69%	<b>1.51%</b>	<b>0.50%</b> -0.01%	<b>0.51%</b> -0.09%	<b>0.60%</b>	<b>22.4%</b>	<b>4.3%</b>	<b>14.4%</b>
<b>Energy</b> Y/Y Change (%)	38	<b>1.02%</b> -0.41%	<b>1.43%</b> 0.27%	<b>1.17%</b>	<b>0.68%</b> -0.44%	<b>1.12%</b> 0.22%	<b>0.90%</b>	<b>49.0%</b>	<b>-26.6%</b>	<b>21.7%</b>
<b>Financials</b> Y/Y Change (%)	29	<b>0.38%</b> -0.25%	<b>0.63%</b> 0.00%	<b>0.63%</b>	<b>0.26%</b> -0.01%	<b>0.27%</b> -0.05%	<b>0.32%</b>	<b>36.6%</b>	<b>1.6%</b>	<b>21.4%</b>
<b>Health Care</b> Y/Y Change (%)	7	<b>0.97%</b> -0.09%	<b>1.06%</b> -1.19%	<b>2.25%</b>	<b>0.40%</b> -0.44%	<b>0.84%</b> 0.11%	<b>0.73%</b>	<b>-19.6%</b>	<b>-23.0%</b>	<b>-10.9%</b>
<b>Industrials</b> Y/Y Change (%)	29	<b>0.39%</b> -0.23%	<b>0.62%</b> 0.19%	<b>0.43%</b>	<b>0.21%</b> -0.09%	<b>0.30%</b> -0.04%	<b>0.34%</b>	<b>16.5%</b>	<b>17.0%</b>	<b>25.5%</b>
<b>Information Technology</b> Y/Y Change (%)	14	<b>2.21%</b> 1.06%	<b>1.14%</b> -0.01%	<b>1.15%</b>	<b>0.85%</b> 0.27%	<b>0.58%</b> -0.11%	<b>0.69%</b>	<b>18.5%</b>	<b>80.7%</b>	<b>64.9%</b>
<b>Materials</b> Y/Y Change (%)	51	<b>0.53%</b> -0.12%	<b>0.64%</b> -0.15%	<b>0.79%</b>	<b>0.40%</b> 0.00%	<b>0.40%</b> -0.20%	<b>0.60%</b>	<b>4.1%</b>	<b>21.2%</b>	<b>23.8%</b>
<b>Real Estate</b> Y/Y Change (%)	23	<b>0.35%</b> 0.05%	<b>0.30%</b> -0.05%	<b>0.35%</b>	<b>0.18%</b> 0.03%	<b>0.15%</b> -0.03%	<b>0.18%</b>	<b>37.5%</b>	<b>-8.7%</b>	<b>22.7%</b>
<b>Utilities</b> Y/Y Change (%)	16	<b>0.21%</b> -0.04%	<b>0.25%</b> -0.02%	<b>0.27%</b>	<b>0.12%</b> 0.01%	<b>0.12%</b> 0.05%	<b>0.07%</b>	<b>11.6%</b>	<b>15.3%</b>	<b>37.5%</b>
<b>Composite Index Total</b>	<b>238</b>	<b>0.66%</b> -0.11%	<b>0.77%</b> -0.04%	<b>0.81%</b>	<b>0.31%</b> -0.11%	<b>0.41%</b> -0.03%	<b>0.44%</b>	<b>25.2%</b>	<b>5.6%</b>	<b>22.9%</b>

Source: Morrow Sodali Analysis, Management Information Circulars, Audited Financial Statements and Bloomberg Finance LP. Sectors defined by Global Industry Classification Standards. TSR assumes dividend re-investments. Sectoral TSR based on relevant S&P/TSX Composite GICS Level 1 Indices.

While no conclusive trends can be identified based on the above, we note the following general sector-specific observations below:

- Directionally, the 'Energy' sector had the strongest one-year TSR of 49.0% for 2021 which also corresponded to the strongest decline in the MRFY burn rate of (0.41)%. This is in line with the inverse relationship observed between TSR and burn rate exhibited by the broader Composite Index.
- The 'Health Care' sector, which experienced the strongest decline in TSR for 2021, also faced a similar decline for burn rates, running contrary to the trend observed for the 'Energy' sector as well as the broader Composite Index. 'Health Care', in Canada, consists of mostly senior Cannabis issuers where a dearth of share price performance has plagued the sector for several years. In such cases, it is not unusual to see a decline in burn rates despite the per-unit cost of equity awards declining given overall executive compensation packages may also be in decline.
- The 'Real Estate' sector exhibits stable granting practices that seem to be insulated from relatively large year-over-year TSR swings. Traditionally, 'Real Estate' has been seen as a relatively stable sector where shareholders are interested in steady distributions. It is not unusual then, that the annual burn ignores share price changes as annual equity award grants, namely full value award grants, would align the executive with the shareholder experience over the long term based on their inherent design without having to consider the alteration of the number of awards granted upfront. However, this type of practice may indicate the granting of the same level of awards year-after-year without taking into account actual performance.



### Companies At Risk with 'Excessive' Burn Rates

A high level of three-year average burn rate signals a closer level of scrutiny from proxy advisors and institutional shareholders. Typically, shareholders and proxy advisors begin to raise concerns when burn rates exceed 1.50%<sup>6</sup>. As can be seen on Figure 6 in red, the 'Health Care', 'Energy' and 'Information Technology' sectors all have more than a third of their constituents exhibiting three-year burn rate

averages in excess of 1.50%. Of note, 29% of 'Health Care' and 'Information Technology' constituents and 21% of 'Energy' sector constituents within the Composite Index have burn rates in excess of 2.00%, which is generally seen as excessive. Thus, issuers within these demographics should pay close attention to managing their burn rates, especially when considering the renewal or adoption of new treasury-based equity plans.

FIGURE 6: THREE-YEAR AVERAGE BURN RATE DISTRIBUTIONS BY SECTOR (COMPOSITE INDEX)

GICS SECTOR	COUNT	3-YR AVERAGE BURN RATE DISTRIBUTIONS (% OF ISSUERS)								
		< 0.25%	>= 0.25%; < 0.50%	>= 0.50%; < 0.75%	>= 0.75%; < 1.00%	>= 1.00%; < 1.25%	>= 1.25%; < 1.50%	>= 1.50%; < 1.75%	>= 1.75%; < 2.00%	>= 2.00%
Communication Services	7	14%	71%	0%	14%	0%	0%	0%	0%	0%
Consumer Discretionary	13	23%	15%	8%	31%	8%	0%	8%	0%	8%
Consumer Staples	11	27%	9%	18%	9%	0%	9%	9%	9%	9%
Energy	38	21%	13%	5%	13%	11%	0%	11%	5%	21%
Financials	29	43%	21%	7%	14%	7%	0%	0%	4%	4%
Health Care	7	29%	0%	14%	0%	14%	0%	14%	0%	29%
Industrials	29	38%	31%	21%	0%	0%	3%	3%	0%	3%
Information Technology	14	21%	21%	7%	14%	0%	0%	7%	0%	29%
Materials	51	31%	10%	24%	14%	10%	2%	2%	2%	4%
Real Estate	23	59%	23%	9%	0%	5%	0%	0%	5%	0%
Utilities	16	56%	31%	0%	6%	6%	0%	0%	0%	0%
<b>Composite Index Total</b>	<b>238</b>	<b>34%</b>	<b>20%</b>	<b>12%</b>	<b>11%</b>	<b>6%</b>	<b>1%</b>	<b>4%</b>	<b>3%</b>	<b>9%</b>

Source: Morrow Sodali Analysis, Management Information Circulars and Audited Financial Statements. Sectors defined by Global Industry Classification Standards. **Red** figures indicate a higher degree of concern where burn rates are in excess of 1.50%; **Light blue** figures indicate moderate degree of concern; **Green figures** indicate a lower degree of concern. While the Composite Index has 238 issuers, 4 cases have been excluded from the counts above given insufficient data to calculate three-year average burn rates. In cases where only two years of burn rate data is available, a two-year average is used as a proxy for three-year average burn rates.

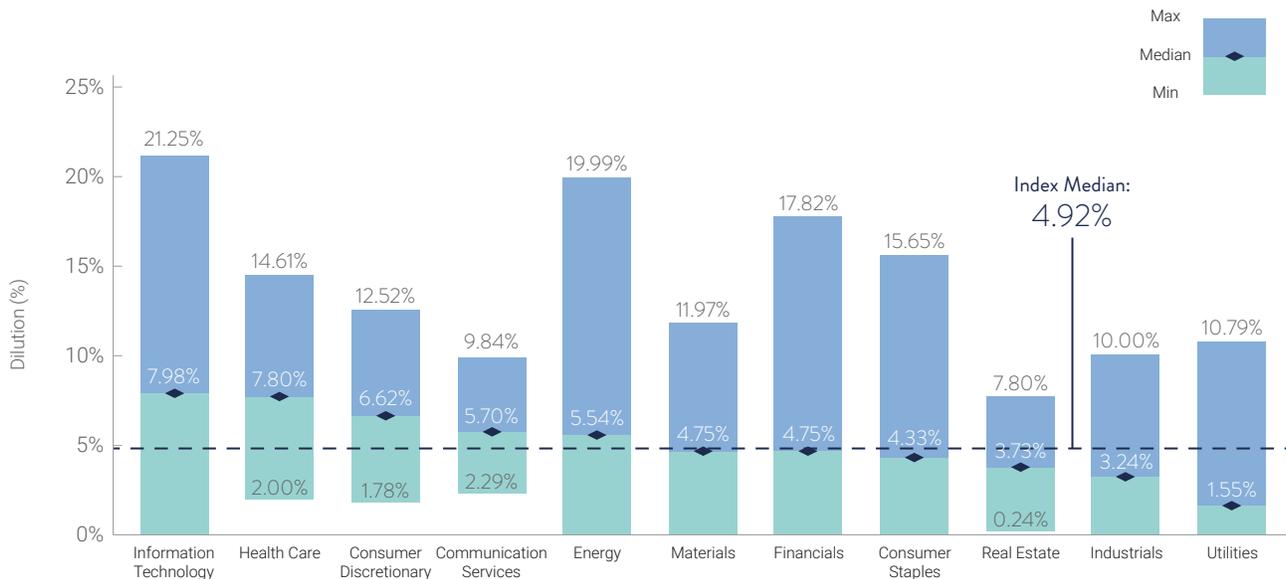
6. Composite Index issuers will stand to lose the maximum number of points available under ISS' EPSC in relation to burn rate once burn rate exceeds 1.50%. Glass Lewis bases part of their quantitative analysis on historic burn rates which are used to project future level of grants. Certain institutional shareholders have bright-line tests where burn rates in excess of 1.50% or 2.00% will trigger against recommendations.

### Dilution Levels are Moderate in Canada

Another metric often assessed by proxy advisors and institutional shareholders is dilution. Surveying total reserve dilution levels across all sectors within the Composite Index for the year-ended December 31, 2021, the median level of total reserve dilution sits at 4.92%, signalling restraint and moderation in Canadian public companies (Figure 7). Unsurprisingly, the 'Information Technology' sector exhibit the highest median dilution at 7.98%, whereas 'Utilities' constituents have the lowest median dilution at 1.55%. These figures are consistent with sectoral dilution trends for the S&P

500 where the 'Information Technology' sector has the highest degree of FY2021 median dilution of 7.6% and 'Utilities', the lowest at 2.6%<sup>7</sup>. Interestingly, while anecdotally, U.S. issuers have always been understood to be more liberal with higher levels of share dilution and burn, taking the 'Information Technology' sector as an example, Composite Index median dilution actually exceed the S&P 500 counterpart, which runs counter to conventional knowledge, signalling a slightly more aggressive reserve regime for Canadian 'Information Technology' companies vis-à-vis U.S. peers in FY2021.

FIGURE 7: TOTAL RESERVE DILUTION BY SECTORS (COMPOSITE INDEX)



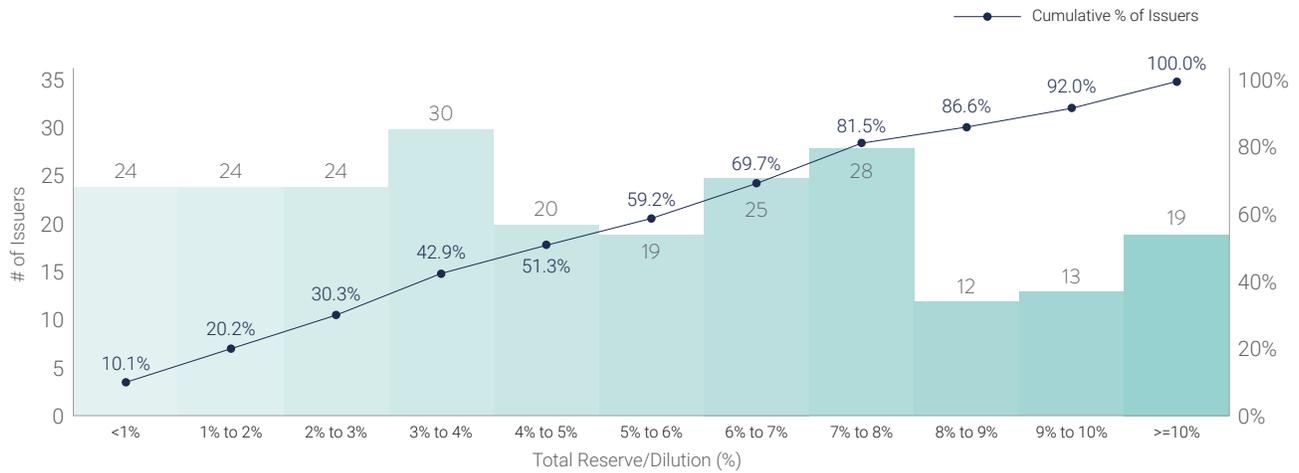
Source: Morrow Sodali Analysis, Management Information Circulars, and Audited Financial Statements. Sectors defined by Global Industry Classification Standards. Dilution as of fiscal 2021 year end, shares outstanding figures obtained from the MRFY management information circular to approximate dilution.

Within the Canadian context, dilution levels in excess of 10% are generally deemed as egregious for large-cap issuers. Empirically, by looking at the distribution of different total reserve dilution levels, we find that only a small percentage of issuers within the Composite Index have dilution levels in excess of 10%, representing approximately 8% of all Composite

Index constituents (Figure 8). Dilution for Composite Index constituents ranges in all sizes from less than 1% to in excess of 10%, approximately half of index constituents have less than 5% dilution. Overall, the vast majority of Canadian Composite Index issuers have reserves less than 10%, in line with best compensation governance practices.

7. ISS Corporate Solutions Whitepaper, "S&P 500 Dilution: One Size Doesn't Fit All", July 2022.

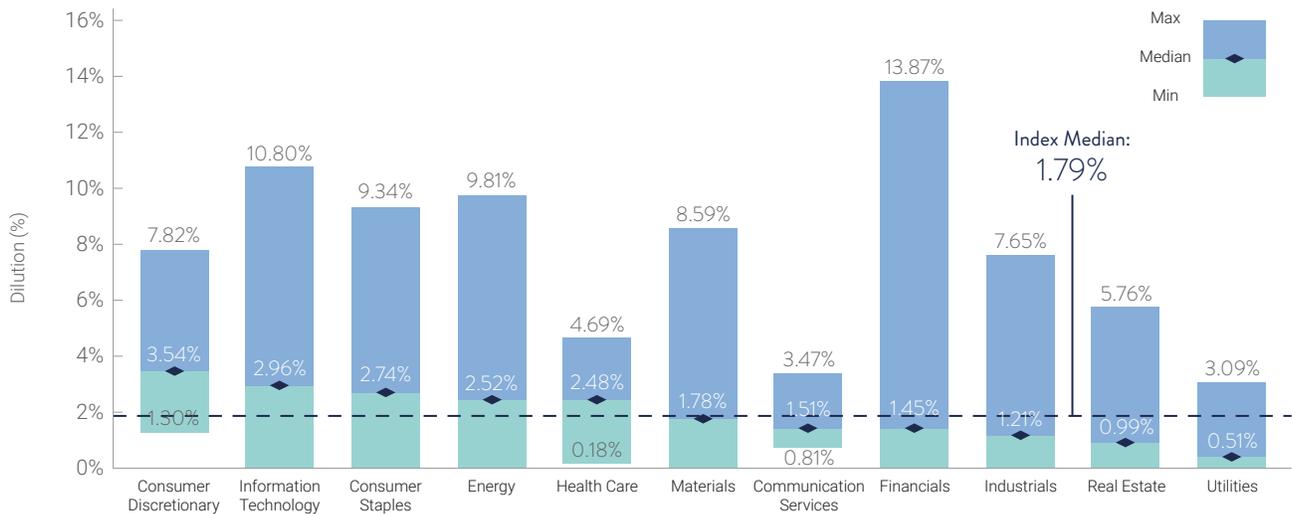
FIGURE 8: TOTAL RESERVE DISTRIBUTIONS (COMPOSITE INDEX)



Source: Morrow Sodali Analysis, Management Information Circulars, and Audited Financial Statements. Dilution as of fiscal 2021 year end, shares outstanding figures obtained from the MRFY management information circular to approximate dilution. Lower bounds are inclusive and upper bounds are exclusive. For example, 1% to 2% includes companies that are greater or equal to 1% but less than 2%.

The median level of overhang<sup>8</sup> of Composite Index constituents remains low at 1.79% (Figure 9). Across sectors, overhang remains substantially below the median total dilution levels, indicating that all sectors have been quite conservative in reserve usage and a large number of shares remain available for future issuances at respective issuers.

FIGURE 9: OUTSTANDING AWARDS OVERHANG BY SECTORS (COMPOSITE INDEX)

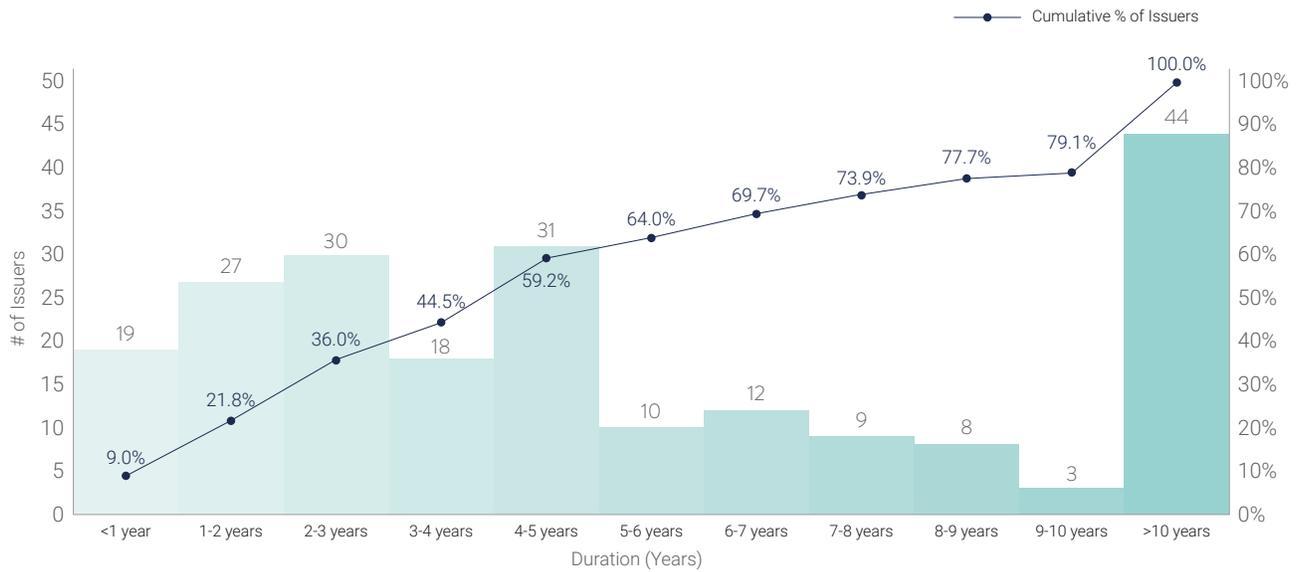


Source: Morrow Sodali Analysis, Management Information Circulars, and Audited Financial Statements. Overhang as of fiscal 2021 year end, shares outstanding figures obtained from the MRFY management information circular to approximate overhang. Sectors defined by Global Industry Classification Standards.

8. Overhang in this case is defined as awards outstanding that have been granted from the treasury reserve, expressed as a percentage of shares outstanding. It does not include awards remaining available for future issuance.

Given the low degree of median overhang vis-à-vis the available reserves within the Composite Index, it is no surprise then that plan duration, which measures the anticipated number of years remaining reserves would last (based on three-year average burn rates) before reserves are depleted, shows that the majority of Composite index issuers can grant awards at their existing pace for a number of years before the reserves are fully exhausted (Figure 10). Only a small fraction of Composite Index constituents (9.0%) have plan durations of less than one year, indicating that generally speaking, Composite Index issuers do not have a pressing need to go back to the shareholders for a reserve renewal or increase.

FIGURE 10: PLAN DURATION DISTRIBUTION (COMPOSITE INDEX)



Source: Morrow Sodali Analysis, Management Information Circulars, and Audited Financial Statements. Lower bounds are inclusive and upper bounds are exclusive. For example, 1 to 2 years includes companies that have plan durations of greater or equal to 1 year but less than 2 years. Duration is calculated by the total number of shares remaining for future issuance, as of fiscal 2021 year end, divided by the company's most recent three fiscal year average burn rate.

### MANAGING PROXY ADVISOR AND SHAREHOLDER RISK

In an increasing share price environment, the rising tides can help reduce a company's burn rate as explained previously. On the contrary, a deflating share price environment causes outstanding awards to lose their retentive value and depletes the reserve more rapidly by virtue of grant-date fair values declining. In this vicious cycle of share deterioration, management will often struggle to retain key personnel while grappling with rapidly depleting reserves. A ballooning and often mostly underwater overhang of awards outstanding would typically also hamper a company's ability to seek more reserves in these cases. Issuers facing such scenarios should pay extra

attention to any upcoming equity plan approval or renewal events, especially in a sector where headwinds are expected or experienced. Should an issuer anticipate a high degree of risk from proxy advisors and shareholders, efforts should be made well in advance of the next shareholder meeting to plan and prepare for the uphill battle when it comes to the vote. Despite all the risks, with careful planning and preparation, an equity plan can still pass the muster of a shareholder vote. Below, we highlight five key recommendations to help issuers mitigate risk and get ahead when it comes to putting equity plan resolutions on the docket for a vote.

## FIVE KEY TAKEAWAYS

### 1. Be Prepared and Engage Early

If you know ahead of time that the upcoming annual meeting would be one where shareholder approval for one or more equity plans will be sought, preparation should start months in advance. A good advisor would be able to tell you how ISS and Glass Lewis will fall on key equity plan recommendations. Having a clear line-of-sight as to how ISS and Glass Lewis would recommend, based on internal usage modelling and external EPSC modelling from your advisors, will serve to inform the level of engagement required. With that knowledge in hand, issuers can take a targeted approach in arranging for engagement meetings off season well ahead of the AGM season.

### 2. Conduct Modelling and Scenario Analysis

Measures such as burn rate and components of dilution are backwards looking and in order to make meaningful changes to the outcomes of such measures, consideration would have to be made well ahead of time before certain compensation decisions are made. In terms of burn rate, an issuer's internal Total Rewards team would be well served to conduct annual multi-year scenario analysis on what grants are expected based on the expected and existing talent pool as well as their eligibility. By managing burn carefully, issuers could have a better idea as to how granting practices today could have impact on how ISS or other shareholders view your equity plan several years down the line. Decisions related to a company's equity plan should also be communicated internally across functional groups well in advance. Changes to equity plans may have significant impacts on the way the CFO-office models the year's capital budget and tax, which in turn affects how the IRO-office communicates guidance based on internal budgets to external investors as well as equity research desks. Without communication early on, certain 'levers' that may otherwise have been available may not be feasible later on given their potential financial or capital budget impacts that would not have been budgeted for or anticipated previously.

### 3. Know Your Shareholders

While this should be obvious to those running the AGM processes, knowing your shareholders and in particular, the degree of influence the proxy advisors have on their voting will be critical to stratifying your shareholder engagement strategy. Certain shareholders care more about some policies than others and oftentimes, institutions may have policies that are even more stringent than ISS and Glass Lewis when it comes to equity plans. In Canada, dilution levels in excess of 10%, or burn rates in excess of 1% or 2% may spell trouble from select institutional shareholders. Certain institutions are averse to stock options outright, or require option terms to be capped with a maximum of five years terms. Other institutions are reluctant to support evergreen or 'rolling reserve' plans. Consideration should be given to the specific design of your equity plans based on the granting needs of the company, while simultaneously trying to avoid any bright-line triggers that may result in negative votes from institutional shareholders. For issuers with large strategic shareholders who are friendly, building reputational capital ahead of time on an annual basis serves to prime them towards being more open to listening to why they may need to override negative ISS or Glass Lewis recommendations in any given year.

### 4. Numbers Matter – Disclose What's Helpful

ISS uses information disclosed by the issuer as inputs to their EPSC model. A good advisor will be able to tell you whether additional disclosure beyond what is required would be helpful or harmful. Oftentimes, disclosing circular or record date figures instead of year-end figures as it relates to a stock option plan could mean the difference between

a pass and a fail, given that changes in the options outstanding or award remaining for future issuance figures all feed into ISS' EPSC analysis. In the same vein, some issuers have opted to disclose outstanding Performance Share Units ("PSUs") at their 'maximum' vesting while other issues have disclosed 'target' awards outstanding. Issuers should carefully consider, with the help of their advisors, how they disclose such information in their management information circular as such decisions may lead to material impacts on the way ISS prices the cost of an equity plan – an impact which could mean a failing instead of a passing score in the EPSC.

## 5. Focus on Messaging

When it comes to issues with equity plan approvals, we most often hear 'retention' as the key theme and defense. Unfortunately, shareholders are becoming less sympathetic to reasons that have to do with overall market conditions or the retention of key management personnel. Messaging to shareholders during your engagement should be specific and fit for purpose. A high performing company with a track record of strong TSR performance will have more leeway than an underperforming one looking to top-up reserves against the backdrop of lacklustre performance. Issuers who have demonstrated the effective stewardship of shareholder capital through restraint and moderation in terms of their overall executive compensation strategy and design (with commensurate levels of strong support for the Say on Pay) will be better off given after all, equity plans are a 'trust me' story. While reserves are requested from shareholders ahead of time, it's up to the board and compensation committee to exercise restraint when making grants once plans are approved. Equity plan votes are not referendums on a company's compensation strategy. Companies who have a clean sheet when it comes to Say-on-Pay and compensation would find that their shareholders could be more easily convinced and less leery of their intentions.

The experts at Morrow Sodali have decades of experience dealing with equity plan design and approvals. Reach out to one of our Canadian experts today to speak to us about your needs and challenges.



### JACKIE CHEUNG

Jackie is Managing Director, Governance & Strategy, leading the Corporate Governance and ESG consulting group at Morrow Sodali

Canada. His practice focuses on complex shareholder matters related to corporate governance, ESG, shareholder activism, M&A, and shareholder sensitive executive compensation matters. He routinely advises public issuers large and small and across all sectors within the Canadian, U.S. and Latin American markets on all matters related to corporate governance and ESG.

As an experienced strategist, Jackie has also advised on over 50 Canadian and global contested critical situations. He has represented both activist shareholders and corporate issuers in some of the largest proxy contests and special situations in

Canada, including most recently, Canadian National Railway Co.'s defense against TCI Fund Management, IAMGOLD Corp.'s defense against RCF Management LLC, Sandpiper Group's shareholder action against Artis REIT, K2 & Associates Investment Management's shareholder action against GT Gold Corp., a concerned shareholder's opposition against GMP Capital Inc.'s transaction with Richardson GMP, Crescent Point Energy Corp.'s defense against Cation Capital and FrontFour Capital Group and Sandpiper Group's shareholder action against Granite REIT.

Previously, Jackie was a Vice President leading the governance and compensation advisory team at one of Canada's largest proxy solicitors. He was also formerly a member of the Canadian executive compensation team at Towers Watson Canada.

# MEET THE MORROW SODALI TEAM

Q&A WITH PIA GOWLAND, DIRECTOR OF DEBT SERVICES TEAM, MORROW SODALI.



**Please introduce yourself to our readers.**

As a Director in the Global Debt Services Team at Morrow Sodali, I am responsible for the management and execution of our firm’s debt-related services in the Americas.

I specialize in advising corporate, FIG and sovereign bond issuers on how to communicate effectively with their bondholders. I have extensive experience in a variety of capital markets transactions as well as in the identification of bondholders.

In summary, our team provides services to bond issuers and their advisors whenever they require support from their bondholders. Typical situations would include Tender Offers, Exchange Offers, Consent Solicitations, Bondholder Meetings, Scheme of Arrangements, Administrations and other debt restructuring related activities.

**What’s been your professional path?**

I joined our firm seven years ago, working in our London office, to enhance the debt services footprint in the firm. In 2020, the Global Debt Services Team grew exponentially, and I started focusing in the Americas. We are now a team of 15 members, based in New York and Stamford, as well as in London, Rome, Paris, Buenos Aires, Hong Kong and Sydney.

Before joining Morrow Sodali, I was Head of Fixed Income Services at UK FTSE 100 Company Capita Plc. Previously, I was a Director of the London office of a firm specializing in the communications with bondholders for 6 years and have also worked for another leading firm in the industry in its LatAm division.

I was involved as Information, Exchange and Tender Agent in several high-profile liability management and debt restructurings, including the transactions launched by The Hellenic Republic, Republic of Argentina, Republic of Chile, Republic of Suriname, Santander, APP Pulp and Paper, Standard Chartered, Ukraine; among others.

**What are the questions your clients should be asking?**

Important gains should derive from a liability management transaction for our clients, bond issuers. Such may include extending debt maturities, deleveraging, accounting benefits, increasing financing flexibility, potentially avoiding a restructuring, among other gains. It is crucial that bond issuers and advisors choose the most appropriate transaction based their objectives, and that such deal is executed in the most efficient manner to achieve the desired outcome (for example, the desired buy-back target in case of a tender offer, or bondholders’ support in the case of a consent solicitation).

“Morrow Sodali’s BondWatch system has been a fundamental innovation in our field since its inception in May 2021. Through this web-based real-time reporting system, clients and advisors can now receive updates of instructions coming in from bondholders in real-time, wherever they are, and remain fully informed as key deadlines approach.”

From an operational perspective, it is important that best practices are implemented. Bondholders should be made aware of the transaction as quickly as possible and their queries, as well as their custodians’ questions, should be answered promptly to promote participation. Clients and the working group should also be made aware of the transaction’s progress by the agent at all times -including any ‘early warning’ findings anticipating the amount of instructions to be submitted- to assess the evolution of the deal. With this information, clients can better manage the variables that affect their transaction and the bankers involved could proactively approach bondholders to promote participation in the offer in question.

**What are the most interesting changes you’ve seen in debt liability management and restructuring over the course of your career?**

Despite the money involved in liability management and debt restructuring transactions, real-time information for issuers and the working group has not been the norm for the last 20 years.

The status of transactions changes constantly, as thousands of investors may be dispersed across different countries and time zones. To stay informed, bond issuers and their advisors have historically had to rely on infrequent updates via emailed spreadsheets.

Morrow Sodali’s BondWatch system has been a fundamental innovation in our field since its inception in May 2021. Through this web-based real-time reporting system, clients and advisors can now receive updates of instructions coming in from bondholders in real-time, wherever they are, and remain fully informed as key deadlines approach.

**What are some of the challenges facing debt issuers in the current market environment?**

Many economists are predicting tough times for certain bond issuers as the global economy faces higher inflation, lower growth and the fallout from the pandemic and the war in Ukraine. All of this has resulted in the new bond issues market being closed to many weaker issuers. Hence they need more creative solutions to addressing problems in paying coupons and/or principal repayments.

And first in assessing the solutions, understanding who owns an issuer’s bonds prior to a liability management or debt restructuring transaction can be very important.

In general, issuers do not know who their current bondholders are. Publicly available bondholder information only provides a small portion of bondholders’ identities, and it is often outdated. And this lack of information might be a challenge for debt issuers.

Why? Such intelligence can serve both commercial and operational purposes: to help in the development of a core strategy to communicate with investors in advance of the launch of a transaction, assist the legal team to construct documents which are responsive to the circumstances of the investor base, to aid the prompt delivery of the offer into all of the correct hands; among others.

We therefore suggest bond issuers to perform an identification of bondholders prior to a transaction.

In addition, when it then comes to implementing a crucial transaction, hiring a team which has the required skills,

personnel, experience and expertise to see such important deals over the line can be vital. Morrow Sodali Global Debt Services provide market-leading examples of all of these.

### What is the role of technology for Morrow Sodali's Debt Services clients?

The role of technology for our clients and their advisors can be crucial.

I mentioned previously how BondWatch raised the bar of standard old-fashioned market practices, and this platform has been so well received by not only the issuers but all advisors on a particular transaction.

Our technological services are also pivotal to clients in complex debt restructurings in which it is necessary to receive paperwork from bondholders or their custodians – in addition to electronic instructions – due to legal requirements, to participate in the restructuring.

Our web-based platforms for all our liability management deals are tailor-made, and provide an easy and efficient user-experience for all stakeholders involved in a transaction.

### Tell us something fun/interesting/unique about you.

I love my job. I am surrounded by talented people and we have a great team, many of them whom I have worked with many years ago and we were able to reunite at Morrow Sodali.

My colleague Kevin Kelly has once baptized me as the 'Bond woman' of Morrow Sodali, I am a fan of Ian Fleming's Bond novels and I take that as a compliment.

I love the mountains and skiing and was a kids' skiing instructor while working in Colorado for six years during my university days - detail from my past life that likely no one knows about, until now.



#### PIA GOWLAND

Pia is responsible for the management and execution of our firm's debt-related services in the Americas.

Pia specializes in advising corporates and sovereign bond issuers on how to communicate effectively with their fixed income investors. She has extensive experience in a variety of capital markets transactions as well as in the identification of investors.

Before joining Morrow Sodali, Pia was Head of Fixed Income Services at UK FTSE 100 Company Capita Plc. Previously, she was a Director of the London office of a firm specializing in the communications with bondholders and has also worked for Georgeson in its Buenos Aires' division.

Pia was involved as Information, Exchange and Tender Agent in several high-profile debt restructurings, including the transactions launched by The Republic of Argentina, Hellenic Republic, Republic of Uruguay, Santander, BBVA, APP Pulp and Paper, Arpeni, Schefenacker, among others.

## CONTRIBUTORS / CONTACTS

<b>TOM SKULSKI</b>	Managing Director, Proxy	T 203-658-9441	t.skulski@morrowsodali.com
<b>MICHAEL VERRECHIA</b>	Managing Director, M&A and Activism Advisory Group	T 212-300-2476	m.verrechia@morrowsodali.com
<b>JACKIE CHEUNG</b>	Managing Director, Governance & Strategy	T 416-203-8565 ext.5	j.cheung@morrowsodali.com
<b>PAUL SCHULMAN</b>	Managing Director, Co-Head of M&A and Activism Advisory Group	T 203-658-9441	p.schulman@morrowsodali.com
<b>GREG REPPUCCI</b>	Senior Director, Sustainability & Corporate Governance	T 203 658 9397	g.reppucci@morrowsodali.com
<b>TOM MARGADONNA</b>	Senior Director, Capital Markets Intelligence	T 203-658-9423	t.margadonna@morrowsodali.com
<b>BILL DOOLEY</b>	Director, M&A and Activism Advisory Group	T 203-658-9388	w.dooley@morrowsodali.com
<b>PIA GOWLAND</b>	Director, Global Debt Services	T 212-324-4934	p.gowland@morrowsodali.com
<b>PETER BELESIOTIS</b>	Vice President, Capital Markets Intelligence	T 203-658-9392	p.belesiotis@morrowsodali.com
<b>GLENN O'BRIEN</b>	Analyst, Proxy	T 203-355-2340	g.obrien@morrowsodali.com
<b>JENNIFER CARBERRY</b>	Senior Director, Marketing	T 203-658-9419	j.carberry@morrowsodali.com

## ABOUT MORROW SODALI

Morrow Sodali is a leading provider of strategic advice and shareholder services to corporate clients around the world. The firm provides corporate boards and executives with strategic advice and services relating to corporate governance, shareholder and bondholder communication and engagement, capital markets intelligence, proxy solicitation, shareholder activism and mergers and acquisitions.

From headquarters in New York and London, and offices and partners in major capital markets, Morrow Sodali serves approximately 1,000 corporate clients in 80+ countries, including many of the world's largest multinational corporations. In addition to listed and private companies, its clients include financial institutions, mutual funds, ETFs, stock exchanges and membership associations.

## NEW YORK

509 Madison Avenue, Suite 1206  
New York, NY 10022  
USA  
+1 212 825 1600

## LONDON

103 Wigmore Street, Marylebone  
London, W1U 1QS  
United Kingdom  
+44 207 355 0921

## SYDNEY

68 Pitt Street, Level 24  
Sydney NSW 2000  
Australia  
+61 2 80 22 79 35

## BUENOS AIRES

Cap. Gral. Ramon Freire 1865  
CABA - 1428 Buenos Aires  
Argentina  
+54 11 4555 7767

## FRANKFURT

Taunustor 1  
60310 Frankfurt am Main  
Germany  
+49 176 6366 7485

## HONG KONG

2/F, The Hive Sheung Wan  
33-35 Hillier Street, Sheung Wan  
Hong Kong  
+852 2319 4126

## MADRID

Calle de Almagro 3  
28014 Madrid  
Spain  
+34 9142 91 412

## MELBOURNE

101 Collins Street, Level 27  
Melbourne VIC 3000  
Australia  
+61 3 9653 7454

## PARIS

29-31 Rue de Courcelles  
75008 Paris  
France  
+33 1 79 97 13 66

## ROME

Via XXIV Maggio, 43  
00184 Rome  
Italy  
+39 06 45212800

## SAO PAULO

Av. Brg. Faria Lima 1485, 1º e 2º andares  
Itaim Bibi, São Paulo - SP, 01452-002  
Brazil  
+55 11 972 783 858

## SEOUL

Suite 1637, Level 16 - Tower 8, 7 Jongro 5gil  
Jongro-gu, Seoul 03157  
Republic of Korea  
+82 2 6226 7267

## STAMFORD

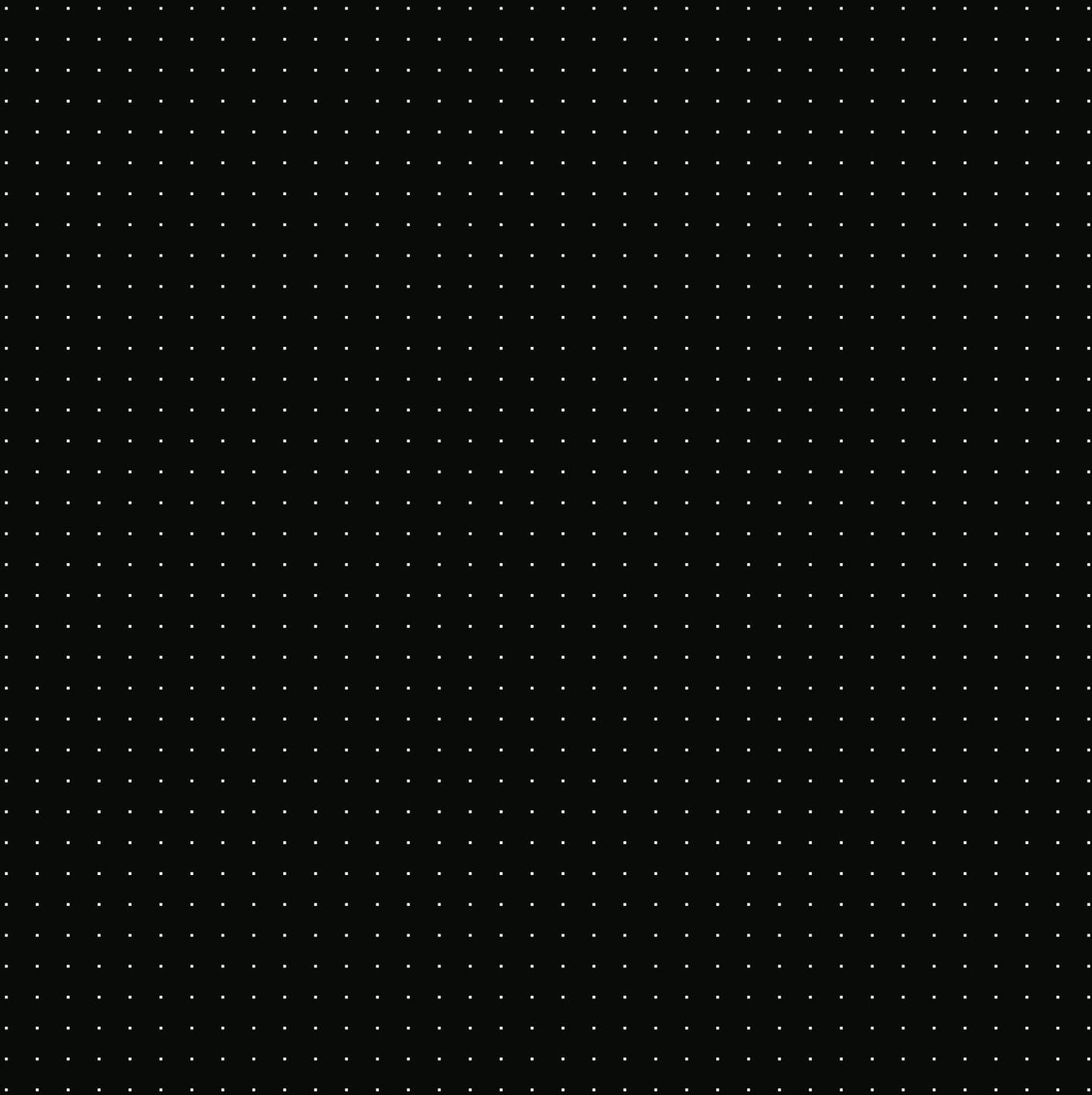
333 Ludlow Street, 5<sup>th</sup> Floor, South Tower  
Stamford, CT 06902  
USA  
+1 203 658 9400

## TORONTO

Brookfield Place, 181 Bay Street, Suite 2860  
Toronto, Ontario M5J 2T3  
Canada  
+1 416 203 8565

## Local Partnerships

BEIJING  
MEXICO CITY  
SAO PAULO  
ZURICH



NEW YORK  
LONDON  
SYDNEY

BEIJING  
BUENOS AIRES  
FRANKFURT

HONG KONG  
MADRID  
MELBOURNE

MEXICO CITY  
PARIS  
ROME

SAO PAULO  
SEOUL  
STAMFORD

TOKYO  
TORONTO