

How Manufacturers Can Adapt To Shareholder Environmental Concerns

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Concern about the environmental impact of manufacturing is growing. The long-term success of a manufacturer may depend, in part, on its strategies for sustainability — but these strategies are not created and perpetuated in a vacuum. Increased shareholder activism regarding sustainability has the potential to affect any public company’s approach, and recent changes in how the U.S. Securities and Exchange Commission (SEC) looks at shareholder proposals on this issue are giving shareholder activists a bigger voice. Manufacturers need to consider taking appropriate steps to adapt to the new environment.

Rule 14a-8

Public companies answer to their shareholders in numerous ways. One way in which shareholders request company action is by making proposals in accordance with Rule 14a-8. Under this rule, a shareholder that satisfies the prerequisites can submit a recommendation or requirement that the company or its board of directors take action for inclusion in the company’s proxy materials, which are distributed to shareholders in advance of the company’s annual meeting.

Not every proposal, however, results in a shareholder vote. By objecting to the SEC,

companies can exclude proposals that are vague or that arise from personal grievances, among other reasons. The most common ground for exclusion allows a company to keep a proposal out of its proxy materials if the proposal deals with a matter relating to the company's ordinary business operations.

Sustainability Proposals

Shareholder proposals cover a broad scope of topics. Increasingly, they deal with environmental and sustainability issues. Environmental and social policy proposals received about 20 percent support from shareholders in the 2013 proxy season, or twice the level of support they received in 2005.

Historically, companies were able to exclude most of these proposals from their proxy materials by showing that they called for an evaluation of risk. According to the thinking at the time, evaluation of risk was ordinary business.

Those days, however, are over. In 2009, the SEC started looking at the subject matter of the risk and whether it involves ordinary business.

The new analysis raised the bar for exclusion significantly. If the subject matter "transcends day-to-day business matters and raises policy issues so significant that it would be appropriate for a shareholder vote," then it generally will not be excluded as long as there is a "sufficient nexus" between the nature of the proposal and the company, explained the SEC.

As a result, more sustainability proposals are making it into proxy statements. In January 2010, the SEC did not allow PPG Industries, Inc., which manufactures paints, coatings, glass and optical products, to exclude a proposal requesting a report on how the company ensures that it responsibly discloses its environmental impacts in all of the communities in which it operates. Later that year, Chesapeake Energy Corporation, America's second-largest producer of natural gas, was required to include in its proxy materials a proposal requesting a sustainability report. In 2012, the SEC denied Cleco Corporation's request to exclude a proposal requesting a sustainability report. That proposal narrowly missed adoption, with 45.6 percent of the shareholder vote favoring the proposal.

Proposals requesting disclosure related to climate change have been particularly successful in avoiding exclusion. Earlier this year, PNC Financial Services Group was unable to exclude a proposal related to the company's assessment of greenhouse gas emissions resulting from its lending portfolio and its exposure to climate change risk in lending, investing and financing activities. Although PNC is not itself a manufacturer, this decision and the others like it mark a significant shift -- one that has had and will continue to have an impact on manufacturers.

Despite the apparent transition toward requiring that more shareholder proposals

be put to a vote, some proposals dealing generally with sustainability are still excluded. For instance, the SEC allowed FLIR Systems, Inc., a thermal imaging systems manufacturer, to exclude a proposal requesting a report on the company's strategies on energy use management because the proposal focused not on sustainability but rather on FLIR's strategies for managing its energy expenses. This decision indicates that, while sustainability is considered a significant policy issue by the SEC, cost reduction is not. Similarly, a proposal requesting a report on an energy utility's use of renewable energy was excluded due to its focus on the company's choice of technologies. Another proposal requesting a summary of plans to eliminate the release of mercury from a global manufacturer's industrial and consumer products was excluded due to its focus on product development.

Adapting to the Current Environment

Given the current landscape, manufacturers face more, and more expensive, demands from activist shareholders than they faced before, but management is not without recourse.

The best way to respond to proposals in this area is to address shareholder concerns proactively. While traditionally the "ordinary business operations" rationale has been the most common ground for exclusion, a company also can exclude a proposal if it has "substantially implemented" the proposal's objectives. If shareholders want something that a company reasonably can provide, then the company might prudently get out in front of the requests, satisfying the shareholders and saving the company time and money.

Management can also meet with shareholders before they make formal proposals. So, if a company receives a letter expressing concern about environmental sustainability from a shareholder or advocacy group, the company should consider meeting with the proponent. When a company opens a dialogue about the issues that matter to shareholders, the process can result in a mutually agreeable resolution before a formal shareholder proposal is submitted.

Finally, if a company does receive a formal shareholder proposal, the company should consider two courses of action. Initially, a company can explore procedural grounds on which to exclude the proposal. Sometimes a proposal fails simply because the shareholder that made the proposal does not own enough stock, or has not owned the stock for the requisite period of time, to qualify and take advantage of the shareholder rights provided by Rule 14a-8. In such a case, the company can ask the SEC to exclude the proposal, and at least postpone the issue.

If the proposal cannot be excluded on procedural grounds, there remains the option to negotiate. Engaging in a dialogue with the shareholder after a formal proposal has been received can be better than adding the proposal to the company's proxy materials because the decision can be made, more or less, on consensual terms,

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without turning shareholders into adversaries by filing an exclusion request with the SEC.

Negotiating to an agreed-upon result, thereby mooting the proposal, is a common result in this particular area of shareholder activism. In fact, environmental and social policy proposals have the highest percentage of proposals withdrawn in connection with direct dialogues between the company and its shareholders.

Conclusion

As companies realize that there is market value in transparency, they are becoming more willing to provide disclosure on matters dealing with sustainability. This is a realization that can benefit manufacturers in the near term as shareholder activism continues to increase and the SEC continues to favor inclusion of sustainability proposals. Companies should be ready to meet the movement head-on. By being aware of these developments and being open to dialogue about sustainability concerns, manufacturers can save time and money, maintain strong relationships with their shareholders and position themselves well for long-term, sustainable success.

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