Sustainability Now Podcast
“BP’s AGM was contentious. This proxy season could be too”
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Bentley Kaplan
Hello and welcome to the weekly edition of Sustainability Now, the show that explores how the environment, our society and corporate governance affects and are affected by our economy. I'm Bentley Caplan, your host for this episode. And on today's show, we're going to talk about the proxy season, that annual ritual where shareholders and company management come face to face or toe to toe. Usually it's a fairly predictable exercise. Proposals get submitted, votes are cast, some things change, most things don't. And both sides go home or back to the office. But this season is going to be a little different. Not just because of what's being proposed or how the votes are going. It's different because the process itself, the machinery that determines which proposals even make it to a vote is being contested. And depending on how that contest resolves the balance of power between shareholders and management could be in a very different place by the time the season wraps up.
Now, we're going to use BP's recent AGM as our entry point, because it handed us a useful example right at the start of this proxy season. But our real focus is going to be broader than BP. That single AGM is a way into the bigger picture. What's changed in how shareholder proposals are handled? What that means for investors, and what the rest of this proxy season might look like. Thanks for sticking around. Let's do this.
To understand why this proxy season feels a little bit different, I should make sure that we all know a little bit about how the proxy process normally works at its most basic. It gives shareholders, the people and institutions that actually own a company through its shares. It gives them a mechanism to put questions and proposals in front of management that might be about pay board composition, disclosure practices, environmental strategy, or any number of other things relating to a company's business. In most cases, proposals go to a vote and the company has to live with the result. In some cases, that result goes against management or against what management recommends, as was the case with BP this year, and we'll get into that in just a moment. Being able to oppose management on a specific issue is a key shareholder right. But it's one that goes hand in hand with what issues get voted on or which ones don't even make it to the ballot in the first place. And that difference between what does and doesn't get voted on is the nuggety heart of this episode.
Now, to discuss this nuggety heart, I brought in Jonathan Ponder out of MSCI's Toronto office, one of our in-house governance experts. Jon's got the kind of mind that can't quite let a story rest until he's traced it back to its underlying mechanics. He's data-driven, comfortably skeptical, and most importantly, he's been watching this proxy season unfold with close attention. So, Jon, let's start with BP. What stood out to you about this AGM? And you know, we'll work towards this – does that matter beyond the company itself?

Jonathan Ponder
So BP I think is a great story because it captures something that we're seeing play out across many markets right now. Rising tensions between management and shareholders on the concept of both access and rights, and what happens when this tension spills into a very public forum. So a Dutch activist group called Follow This filing on behalf of Dutch pension funds submitted a proposal asking BP to disclose how its strategy performs under declining oil and gas demand scenarios. BP's board decided to block it unanimously, claiming a legal defect under UK company law. Interestingly, though, shell accepted a similarly worded follow this resolution at its own AGM. So right out the gate, BP's decision looks strategic rather than purely legal. And what we think really alarmed institutional investors wasn't any single move in isolation. It was in combination. At the same time as the company was blocking this proposal, it attempted several further moves, switching AGM's to virtual only, which may limit shareholders ability to engage in person. Plus retiring climate disclosure requirements that shareholders had previously voted to improve. Together, this pattern could look like a systematic attempt to reduce transparency and insulate management from oversight. And I think what's notable, what's notable here is that investor response was immediate and also coordinated. Legal & General, Railpen, Robeco, Border to Coast. All pre-declared opposition before the AGM even started. Both management proposals failed, falling around forty seven percent votes for well short of the seventy five percent threshold needed to pass. And the chair vote also tells the same story. While most of BP's other directors were re-elected with ninety four to ninety seven percent support, even as a newly minted chair, Albert Manifold came in at just eighty two percent votes for. And what we think is that this gap reflects just how deep institutional frustration has become with BP's governance. It shows what happens when management tries to sideline shareholder oversight, especially when there's no hard legal mechanism to push back. The Follow This proposal never got voted on because BP blocked it, and that was the end of it. And now what I'd like to do is contrast this with what we'll see in the US, where shareholders are facing the same kind of exclusions, yet we're able to get their proposals reinstated by court order. And the existence of this legal right and the ability to fight back is exactly what's being contested within that market.

Bentley Kaplan
Okay, so there is a lot that we could talk about when it comes to BP's underlying strategy, the decision to roll back some of its renewables commitments, the specifics of what those disclosure requirements actually covered, and what investors think about the company's risk profile under an energy transition. If you think about three major market events for oil and gas in the past few years, from Covid to the Russia-Ukraine war to disruptions in the Strait of Hormuz, shareholders may be genuinely interested in knowing the company's strategy when it comes to climate, fossil fuels and renewables. But Jon's point is that when you zoom out far enough, this becomes a shareholder rights story, not a BP story alone. The proposal from Follow This wasn't only about BP's climate credentials. It was also a test of something more fundamental whether shareholders can compel certain types of disclosure when management would just rather not. And BP's ability to block the proposal without it coming to a vote is what flags the bigger structural question. It's one that is resonating with events in other markets, including the US, where the same underlying tension is playing out. But this time through a very different legal

architecture. And if anything, what's going on in the US this season is even more significant because it goes directly to the rules of the game itself. So Jon, next, I think you should walk us through what's changed in terms of how shareholder proposals are being handled in the US.

Jonathan Ponder
So the US is unique in a way, because the foundation of this interface between shareholders and management has been codified for a long time. The foundation here is rule 14A-8, which has been in place since nineteen forty two. And the purpose of this is essentially to give shareholders a federally enforceable right to put proposals on corporate ballots. Companies as a corollary to this rule have always had grounds to exclude proposals. There are thirteen listed reasons covering things like ordinary business vagueness, resubmission, thresholds and so on. But none of this is new and has generally been ingrained in the market for longer than I've been paying attention to it. At least. What appears to be changing, however, is the process around this. If a company wanted to exclude a proposal, it had to get independent sign off from the SEC's Division of Corporate Finance to what we call a no action letter. And this process acted as a little bit of what I'd consider a referee. For example, independent review before an exclusion took place. They'd take a look at this and basically decide which side was being unreasonable, if that was the case, and then judge accordingly. However, as of November of twenty twenty five, the SEC decided to take a step back, citing resource constraints following the government shutdown, and basically said that companies now can self-certify what they call a reasonable basis to exclude these proposals. Meaning that the referee has essentially walked off the field and will now let the players govern the game. And it's, I think, critical to base this in some sense of scale, to understand what is now being unpoliced submissions of these shareholder proposals have grown over the years and also of these, no action letters have grown over the years from around eighty per season in twenty twenty one to more than three hundred in twenty four, twenty five. And this season, we've actually seen this this reduced by about forty percent year on year. But what we think is that that drop may be reflecting silent exclusions and withdrawals on the part of proponents. Given this, this lack of structure and this signaling from the SEC that they might not get a fair shake. This doesn't just affect what we would call ESG or climate proposals. But this also impacts things like board composition, executive pay, political spending, audit quality, the kinds of things that shareholders have been putting to vote for longer than I've been alive. And probably you as well, Bentley. And, and these mechanisms have all been weakened. So the response from the shareholders’ side – litigation. We've seen fewer than thirty rule 14A-8 lawsuits in the past fifty years but now multiple new cases have landed within just weeks of the policy change.

Bentley Kaplan
So, Jon, I'm going to jump in there because you've given me the crib notes for these before the episode. But I think, you know, what really jumps out is the speed at which some of these cases have been resolved. That's really striking. So AT&T excluded a diversity disclosure proposal relating to their EEO-1 form. It's something the company had voluntarily published for years before quietly stopping in twenty twenty four. And, you know, meanwhile, industry peers Verizon and T-Mobile continue to publish theirs. Then the New York City pension funds sued and AT&T settled in a matter of about nine days, was the number you gave me. And PepsiCo

did something quite similar. Axon enterprise held out for three weeks on a political spending proposal before agreeing to a five year disclosure commitment. And looking at these, you know, very quick settlements. It might suggest the companies didn't have the conviction or maybe even the appetite for drawn out legal actions. But we are not here to speculate. I think the key point to emerge from this is that investors are very much going to be watching the next legal steps quite closely. If the courts are going to suddenly become, you know, arbiters of what makes it onto a company's AGM ballot. But, Jon, you say that there are two cases in particular that have really set the legal stakes for the season. So why don't you give us some context about those two cases?

Jonathan Ponder
I would turn to BJ's Wholesale Club, which I would call the landmark of the season, at least so far. The New York State Pension Fund proposed that the company conduct a deforestation risk assessment on its private label brands and publish a report within the year. BJ excluded it as ordinary business, assuming that supply chain management is day to day and that shareholders shouldn't micromanage. However, the problem with this argument is that private labels are twenty five percent of the company's annual sales and are a growing segment. And deforestation risk is explicitly identified in the company's own 10-K as a key business risk, which would make it material by the company's own disclosure. Judge Sorokin granted a preliminary injunction on April twenty second, the first of its kind in at least a decade. And the more significant part of this ruling is the legal reasoning. He rejected the majority reasoning in Trinity Wall Street versus Walmart, the case companies have been using as a blanket shield for ordinary business exclusion, siding instead with the dissent in that case and the SEC's own prior guidance. This, in turn, will weaken the exclusion concept as a default defense going forward for all companies. And then there's the case going directly at the SEC itself As You Sow and ICCR filed suit on March nineteenth arguing that the SEC violated the Administrative Procedure Act by changing how rule 14A is implemented, removing the SEC's role in evaluating disputes and limiting shareholders ability to respond without following the required notice and commitment and comment ruling process. If successful, it forces the SEC to go through formal rulemaking to make any changes, including public comment periods and congressional scrutiny, which is, of course, a much higher bar. This is still pending, but the outcome there changes the calculus for every other case that I just mentioned.

Bentley Kaplan
So I must admit, it is very tempting to listen to you walk through those individual cases and not ready to get pulled into the specifics, you know, to say, well, obviously deforestation risk matters for a company where its private labels are a quarter of annual sales, and it's already a risk that the company flags in its 10-K. Maybe you feel equally strongly on the other end that deforestation risk is not really part of business. A company shouldn't have to report on these peripheral environmental issues. But, Jon, I take your point. The more important question isn't always the content of any particular proposal. It's whether shareholders have a reliable route to get issues in front of management and in front of their fellow shareholders at all. Getting an issue to a vote is no guarantee it's going to pass, but that voting process is what really matters. And looking overall at the US market, you

might see the balance of power tipping slightly away from shareholders and being able to bring these issues for a vote. But I think it's worth noting the direction of travel isn't uniform globally, right? So parts of Asia are actually moving in the opposite direction right now. South Korea has passed corporate governance reform requiring directors to act specifically in shareholders interests. You know, that's a direct challenge to the family controlled tribal structures that have long concentrated power right at the top. Japan is in the middle of a corporate governance code Revision and Companies Act amendments that would strengthen minority shareholder protections. Those markets are trending towards more shareholder rights and not fewer. And I think what's consistent across markets, whether that is fighting for improved shareholder rights or successfully seeing that trend happen, is who's driving it, right. The same large pension funds and global asset managers using whichever legal lever is available in each jurisdiction. You could argue that the BJ's injunction and the BP chair vote are the same ownership instinct expressed through different legal systems. So with all of that in mind, and with the season still very much alive, Jon, you know, if you were to give some advice to investors, what should they be looking for as the season unfolds?

Jonathan Ponder
I think you've articulated that pretty well, probably better than I could that this season will be one of uncertainty. I mean, we're only at what, April May and, um, and seeing litigation flying around the room like nothing else. I think that there are three outcomes probably that are worth holding in mind and kind of following as we see all this play out. Um, first and I, I would call this sort of the, the middle of the road could possibly be the, the best outcome here is that litigation like this becomes a deterrent. So because the SEC has decided that they no longer want to act as the referee, companies will self-correct, exclusions drop off, and this policy change becomes effectively moot because nobody wants to be the next BJ's or the next PepsiCo or AT&T. Second, the stronger cases get fought. A body of case law obviously will develop clarifying where this exclusion line actually sits. And of course this will be incredibly messy in the short term and I would add costly, but potentially useful for everyone in the long term. Ideally, this would lead to clearer guidance and less need for that referee, just given the fact that the boundaries have been explicitly set. So, messy now, but potentially more stable later. And the third here would be that APA lawsuit that I mentioned before succeeds and basically forces the SEC to step back into the field to restore formal review through rulemaking. And this would reset the dynamic to before any new case law has had the chance to solidify and also will raise the bar significantly for any future weakening of the mechanism, essentially saying that they can no longer back out of what is their responsibility. But there is another side to that last scenario. If that lawsuit fails and the SEC proceeds with shareholder proposal modernization rulemaking, which is already on the spring twenty twenty six agenda, the mechanism itself, not just the. No action process could be restructured or permanently weakened. So this no action withdrawal could actually be the opening salvo and not the end state of the softening of rules for retail investors. And I would actually say for most people who own shares, either through pension funds or large asset managers, whether they know it or not, this matters more than it might look. The New York state pension fund that sued BJ's, for example, manages retirement savings for state and local government employees. This lawsuit wasn't just filed by some abstract institution people that are totally disconnected from the rest of the world. It was filed on behalf

of teachers, police officers and public sector workers. And I would say that the critical overall takeaway is this rule fourteen eighty eight exists partly because retail shareholders can't individually engage corporate management at scale. Institutional investors using this proposal mechanism are acting as a proxy or on behalf of these dispersed ownerships. And when that mechanism is weakened, the people who lose the most voice aren't the big institutions who will always find another way into the boardroom to engage. It's the individual investor at the end of the chain whose representation becomes slowly eroded.

Bentley Kaplan
Exactly. So this may seem like a story about procedures and legal technicalities, but as Jon puts it, the institutions filing these lawsuits are doing it on behalf of people who may not be dialed in to the gritty details of proxy contests, and who may just be trusting that the system designed to represent their interests is actually functioning. Time and time again, studies have shown clear links between good governance, lower risk, and higher profitability over the long term, and put in that light, we might see more shareholders rolling up their sleeves to make sure that happens. And that is it for the weak? A very big thanks to Jon for bringing his usual rigor and a healthy dose of skepticism to what turned out to be a topic that really rewards close attention. We'll try and get Jon back on the show towards the end of the season, to see how white knuckled shareholders have been over the long, long months. As always, a massive thank you for tuning in. If you like what we're doing, please subscribe, rate and review us wherever you get your podcasts. It really makes a difference. Until next time, take care of yourself and those around you.

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