

Overly prescriptive shareholder proposals and questionable corporate governance practices were some of the more complex issues we faced in the 2023 proxy season. We illustrate our voting thought process and our ongoing engagement with corporate boards and management teams.

We take the opportunity in the third quarter to profile some of the more significant proxy votes from the season. As an active manager, proxy voting is one of the tools we have at our disposal to exert influence on the companies we own in the direction of long-term shareholder value creation. Below, we highlight three such examples from the 2023 proxy season, where the issues at hand were particularly controversial.

EXAMPLE 1: DOW, U.S. COMMODITY CHEMICAL COMPANY

One of the key environmental issues facing the chemicals sector is exposure to revenue generated from plastic products, particularly single-use plastic. The financial materiality of this issue is largely driven by regulation seeking to ban plastic products with limited recyclability and/or regulation that encourages “circularity” (i.e., a system where plastic materials are reduced, redesigned, and reused or recycled to recapture any “waste” as a resource for new plastic materials). A truly circular economy would result in a reduction in virgin plastic demand, which would be an adverse outcome for virgin plastic producers such as Dow.

Given the materiality of this issue, it is perhaps not surprising that a shareholder put forward a proposal for Dow to commission an audited report on the business impact from reduced plastics demand. The proposal made specific reference to one particular scenario—*System Change Scenario*—put forward in a report by The Pew Charitable Trust. While we agree with the materiality of this issue, we decided to vote against the proposal for two considered reasons:

1. Dow is already adopting principles of circularity. For example, Dow has committed to making 100% of products reusable or recyclable by 2035, commercializing three million tons of circular and renewable solutions annually, and has entered into various joint ventures to develop circular plastics.
2. We viewed the proposal itself as overly specific and narrowly deterministic in nature, such that the demands were a poor use of management time and resources. The specific scenario put forward by the proponent is highly theoretical, hypothetical, and, in our view, unlikely to materialize as stated. Many of the assumed interventions in the plastic value chain have no basis in existing or proposed regulation. Even if all plastics bans currently under consideration came into effect, the estimated result would affect less than 2% of Dow’s total sales based on 2022 revenue.

While we voted against this specific proposal, we continue to engage Dow management on this topic as part of our [Opportunity List](#). Our ongoing research and engagement is focused on better understanding the evolving regulatory environment, determining which products may move in and out of the scope of single-use plastic regulation, and advocating for greater clarity on the associated capex and opex required to develop a more circular plastics business.

EXAMPLE 2: ENEL, DIVERSIFIED ITALIAN UTILITY

As long-term shareholders, one of the more important votes we cast for companies every year is for the individual directors that comprise the board of directors. The role of the board is to oversee the strategic decisions of the management team, ideally with long-term shareholder value creation in mind. This is why we voted for the slate of directors at Enel proposed by activist Covalis Capital. The slate proposed by Covalis would have meant a majority independent board and independent Chairman, which, in our view, would have best represented the interests of non-government shareholders who still own the majority of shares outstanding. The other options were the Italian government’s slate (the government owns ~24% of shares outstanding) and a slate proposed by the Assogestioni, an association of Italian asset managers.

The backdrop to this vote was the decision earlier in the year, under pressure from the Italian government, to replace the former CEO, Francesco Starace. We were supportive of the business strategy pursued under Starace’s leadership. Absent a credible reason for the government’s loss of confidence in Starace, we generally view leadership transitions under such circumstances as potentially value destructive. The influence that the Italian government maintains over decision-making at Enel—without a controlling stake—provided further justification to back the slate of independent directors proposed by Covalis.

Unfortunately, the activists’ slate received less than 10% of the vote, while the government slate received 49% and the association’s slate received 43%, resulting in six government nominees and three association nominees being named to the nine-person board. Nevertheless, we will continue to engage the new management team to ensure that there is business continuity, particularly with respect to Enel’s transition plan, which we have long viewed as industry-leading, and the prudent use of capital.

EXAMPLE 3: DUERR, GERMAN INDUSTRIAL EQUIPMENT AND ENGINEERING AND CONSTRUCTION COMPANY

Repricing any aspect of an executive compensation plan mid-cycle falls afoul of our philosophy on executive compensation. Such adjustments are typically made to insulate management from a negative event or further capitalize on a positive event. Either defeats the purpose of the fundamental pay-for-performance principle that should underscore all compensation packages. That is why we decided to vote against the pay package for the CEO of Duerr.

Duerr changed the short-term incentive (STI) target—100% EBIT margin based—in the CEO’s pay package retrospectively to insulate the ultimate payout from negative events, specifically the ongoing China shutdown and Ukraine war. The change resulted in payouts above the target of 110%, equating to approximately EUR1M rather than the EUR600k that would have been paid out if the goalposts had not been moved.

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We engaged with the company to express our dissatisfaction with this decision. We learned that the decision was taken by the board to reward the CEO for hard work done throughout the year, which, in the board's view, had been overshadowed by external business shocks out of the CEO's control. While we acknowledge that the management team is executing well, we could not, in good conscience, vote in favor of a compensation package that altered terms to reward management at the expense of long-term shareholders. Ultimately, the company did the right thing in other ways, specifically by not paying out the long-term incentive (LTI) because 3-year EBIT margin targets were missed, the total compensation was not out of line with the market, and the company updated 2023 compensation to include two additional helpful metrics—free cash flow in the STI and total shareholder return in the LTI. We will re-engage on this issue, if required, in the 2023 compensation cycle.

We will continue to use our vote, as needed, to establish our position on an issue and/or escalate concerns. We use our vote in combination with direct engagement, such that we communicate our position on controversial issues directly to the management teams of companies we own. As an important element of active ownership, we will never outsource proxy voting to a separate team or third party. Proxy voting has been and will remain a fundamental part of our ESG-integrated investment process.

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