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Meridian Client Update

Controversy Over Coca-Cola's 2014 Equity Plan Proposal

Equity plan proposals brought to shareholders for approval rarely meet any level of meaningful resistance. That was not the case with The Coca-Cola Company's request for shareholders to approve its 2014 Equity Plan that included a share pool of 500 million shares. Coke's largest shareholder, Warren Buffett, publicly objected to the proposed equity plan.

Mr. Buffett was not alone in his concerns that the proposed equity plan could be excessively dilutive to shareholders. David Winters the CEO of Wintergreen Advisers whose clients own over 2.5 million shares of Coca-Cola noted in a letter to Coca-Cola's Board of Directors that the proposed equity plan would "significantly erode the per-share value of Coca-Cola shares" and if approved would "dilute existing shareholders by a Company estimated 14.2%."

Despite the public objections from major shareholders, ISS recommended a vote **FOR** Coca-Cola's 2014 Equity Plan, primarily on the basis that the transfer of value from shareholders to employees under the plan was reasonable according to ISS standards.

Ultimately, Coca Cola's 2014 Equity Plan proposal received support from 83% of the votes cast by shareholders at its 2014 annual meeting. However, Warren Buffett's Berkshire Hathaway, which owns 9% of Coca-Cola's stock, abstained from voting. Coca-Cola does not count abstentions when tallying vote results. If abstentions did count, the support levels for the 2014 Equity Plan would drop to 72% of the total votes cast. In either event, the level of shareholder support for Coca-Cola's equity plan proposal was very low for an S&P 500 company. Typically, proposed equity plans by S&P 500 companies garner support from at least 90% of votes cast.

Meridian Comment: Many commentators have linked the resistance to Coca-Cola's proposed 2014 Equity Plan to the Company's failure to adequately explain the plan's fungible share pool and/or to shareholders not considering the Company's typical equity mix in assessing the likely dilutive impact of the fungible share pool. Neither appears to be the case.

Coke's 2014 proxy went to great lengths to explain and illustrate the operation and impact of the fungible share pool. The Coca-Cola proxy provided the following explanation of the fungible share pool:

> **"Fungible share pool.** The 2014 Plan uses a fungible share pool under which each share issued pursuant to an option or stock appreciation right ("SAR") will reduce the number of shares available under the 2014 Plan by one share, and each share issued pursuant to awards other than options and SARs will reduce the number of shares available by five shares."

The Company's proxy went on to state the dilutive impact of the fungible share pool "will depend on several factors, the most important of which is the type of awards made under the 2014 Plan."

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To illustrate the range of potential dilution, Coca-Cola's proxy included the following table that shows potential dilution "assuming that all authorized shares under the 2014 Plan are granted (i) 100% as stock options, (ii) at the current mix of approximately 60% stock options and 40% full value awards and (iii) 100% as full value awards."

Mix Of Stock Options/Full Value Awards	100% Stock Options	Current 60%/40% Mix of Stock Options/Full Value Awards	100% Full Value Awards
Potential Dilution	16.8%	14.2%	10.0%

Overall, the proxy provided investors the knowledge necessary to understand the nature and impact of the fungible share pool. Therefore, it seems highly unlikely that Coca-Cola could have improved the vote results simply through making a more exhaustive disclosure on the fungible share pool.

In an interview with CNBC, Mr. Buffett understood that Coca-Cola will not necessarily issue all shares under the fungible share pool by acknowledging that the actual number of shares issued under the pool could "equate to 340 million shares" based on the Company's current mix of stock options and full value awards. Nonetheless, Mr. Buffett made clear that the potential dilutive impact of Coke's proposed equity plan would still be significant.

Meridian Comment: The principal take-aways from Coca-Cola's experience are threefold: (i) investor support for certain levels of dilution does have limits, (ii) in advance of proposing a new equity plan or seeking additional shares for an existing equity plan companies, companies should fully vet these proposals with major shareholders, and (iii) companies should not simply focus on how many shares will pass muster under the ISS model, but also what is a reasonable number of shares to cover several years of expected incentive grants.

Proxy Advisors Respond to European Commission Proposal to Require Guarantees Regarding Proxy Advisors' Research

In April 2014, the European Commission proposed a revision to the 2007 European Union Shareholder Rights Directive ("Directive"), which includes measures to regulate proxy advisory firms.

The proposed revision to the Directive would require proxy advisors to implement measures to guarantee their vote recommendations are accurate and reliable. In response, on May 12, 2014, a group of proxy advisors that included Institutional Shareholder Services and Glass Lewis issued a position paper opposing the "hard regulatory approach" contemplated by the proposed Directive.

Under the proposed revision, proxy advisors would be required to:

- Adopt and implement adequate measures to **guarantee** that their voting recommendations are accurate and reliable, based on a thorough analysis of all the information that is available to them.
- Publicly disclose certain key information related to the preparation of their voting recommendations, including the essential features of their methodologies and models, whether they have taken into account national market, legal and regulatory conditions, the extent and nature of dialogue with listed companies and the total number of staff involved in the preparation of the voting recommendations.

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- Publicly disclose to their clients and the listed companies concerned information on any actual or potential conflict of interest or business relationships that may influence the preparation of their voting recommendations.

The position paper of the proxy advisors raises concerns regarding "disproportionate and unworkable" standards arising from the requirement that their research be "guaranteed", countering that such research, analysis and recommendations are "points of view based on investors' policy preferences."

The proposed revision to the Directive is being considered by the European Parliament and the Council of the European Union. If it is adopted, each EU member state would be required to implement the proposal within 18 months.

Meridian Comment: The split among European regulatory authorities between a self-regulatory, principle-based approach and a rules-based regime may provide a framework for future discussions on SEC regulatory oversight of the proxy advisor industry in the U.S. Many U.S. companies have raised concerns about the accuracy and reliability of the research underlying proxy advisory firms' vote recommendations, as well as the inadequate processes and procedures for resolving errors in advance of their shareholder meetings.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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