

## THE PRICE ISN'T RIGHT: SHAREHOLDER PROPOSALS AS OPPORTUNITIES FOR INSTITUTIONAL INVESTORS TO RESTORE FIRM VALUE AND REDUCE PHARMACEUTICAL PRICES

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*Surging pharmaceutical prices in the United States create financial strain for patients, insurance companies, and state and federal governments. Regulatory delays and coverage denials due to product prices can also affect shareholders of pharmaceutical companies by depressing stock prices. While a number of industry leaders have acknowledged that dramatic price hikes can damage their businesses, many pharmaceutical companies have not demonstrated a willingness to scale back prices.*

*This Note considers the use of shareholder proposals to address drug pricing policies at the company level. While shareholders of most companies are generally unable to address pricing policies, a carve-out created by the Securities and Exchange Commission allows shareholders of publicly traded pharmaceutical companies to do so. This Note studies how shareholders can use the carve-out to push for price restraint by either causing a company to include a price restraint proposal in its proxy materials and annual meeting or causing management to negotiate with proponent*

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*shareholders in order to convince the shareholders to withdraw their proposals.*

*By evaluating the success of prior attempts to impact drug prices through shareholder proposals, this Note concludes that institutional investors are the linchpin of shareholder success, whether that success is through a vote at the annual meeting or a compromise at the negotiation table. This Note therefore calls on institutional investors to evaluate their portfolios and consider using shareholder proposals to unlock firm value and relieve the financial pressure created by rapidly rising drug prices.*

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## I. INTRODUCTION

By 2020, Americans are expected to spend \$610–\$640 billion annually on pharmaceutical drugs.<sup>1</sup> These surging costs create financial pressure for patients,<sup>2</sup> insurance companies,<sup>3</sup> and, through funding of programs like Medicaid, state and federal governments.<sup>4</sup> Despite political insistence

<sup>1</sup> THE IMS INSTITUTE FOR HEALTHCARE INFORMATICS, MEDICINES USE AND SPENDING IN THE U.S. 5 (2016), <https://morningconsult.com/wp-content/uploads/2016/04/IMS-Institute-US-Drug-Spending-2015.pdf> [perma.cc/X4RZ-DRWB].

<sup>2</sup> STAFF OF S. SPECIAL COMM. ON AGING, 114TH CONG., SUDDEN PRICE SPIKES IN OFF-PATENT PRESCRIPTION DRUGS: THE MONOPOLY BUSINESS MODEL THAT HARMS PATIENTS, TAXPAYERS, AND THE U.S. HEALTHCARE SYSTEM 98 (Comm. Print 2016) [hereinafter SPECIAL COMM. ON AGING, MONOPOLY].

<sup>3</sup> *Id.* at 110.

<sup>4</sup> *Id.*; Letter from Meredith Miller, Chief Corp. Governance Officer, UAW Retiree Med. Benefits Tr., to Vertex Pharm. Inc. S'holders (May 15, 2015), <http://apps.shareholder.com/sec/viewerContent.aspx?companyid=VRTX&docid=10707393> [perma.cc/XS4S-7F2U] [hereinafter UAW, Letter to Vertex].

on price containment,<sup>5</sup> many pharmaceutical companies have not demonstrated a willingness to scale back specialty drug prices,<sup>6</sup> even while industry leaders acknowledge that price hikes damage their businesses.<sup>7</sup>

Shareholder proposals<sup>8</sup> are a tool through which both institutional and independent shareholders can force management to consider certain corporate policies by holding a shareholder vote. This process allows shareholders to influence corporate governance, communicate their views to other shareholders, and pressure management to implement

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<sup>5</sup> See, e.g., Press Release, Senate Special Comm. on Aging, Inquiry Into URL Pharma and Avanir Pharm. Pricing of Popular Prescription Drugs Begins (May 24, 2011), <https://www.aging.senate.gov/press-releases/inquiry-into-url-pharma-and-avanir-pharmaceuticals-pricing-of-popular-prescription-drugs-begins> [perma.cc/4X4P-NVTV]; Press Release, Senate Special Comm. on Aging, Collins, McCaskill Open Senate Investigation into Rx Drug Pricing, Announce Intention to Hold Hearings (Nov. 4, 2015), <https://www.aging.senate.gov/press-releases/collins-mccaskill-open-senate-investigation-into-rx-drug-pricing-announce-intention-to-hold-hearings> [perma.cc/TQ76-45J7]; see generally STAFF OF S. SPECIAL COMM. ON AGING, 114TH CONG., SUDDEN PRICE SPIKES IN OFF-PATENT PRESCRIPTION DRUGS: THE MONOPOLY BUSINESS MODEL THAT HARMS PATIENTS, TAXPAYERS, AND THE U.S. HEALTHCARE SYSTEM (2016).

<sup>6</sup> Specialty drugs are a designation of pharmaceuticals classified as high-cost and often include biologic drugs, drugs with special handling requirements, and drugs with limited distribution. Patrick P. Gleason, et al., *Health Plan Utilization and Costs of Specialty Drugs Within 4 Chronic Conditions*, J. MANAGED CARE & SPECIALTY PHARMACY (2013), <http://www.jmcp.org/doi/10.18553/jmcp.2013.19.7.542> [https://perma.cc/7YM5-SZYH]. For a discussion on surging specialty drug prices, see *infra* Section II.A.

<sup>7</sup> See Liz Hoffman & Michael Rapoport, *Valeant's Michael Pearson Admits Aggressive Drug-Price Increases Were a Mistake*, WALL ST. J. (Apr. 27, 2016, 8:32 PM), <http://www.wsj.com/articles/valeant-steering-away-from-aggressive-price-increases-officials-tell-senators-1461790103> [perma.cc/ZD53-L4WC]; see also *Bill Ackman Asked for Information in Drug Pricing Probe*, FORTUNE (Mar. 24, 2016), <http://fortune.com/2016/03/24/bill-ackman-valeant-drug-price-investigation> [perma.cc/J55X-RALJ].

<sup>8</sup> For an explanation of shareholder proposals, see *infra* Section III.B.

their proposals “at both the shareholder-to-shareholder and shareholder-to-management levels.”<sup>9</sup>

Since the 1990s, shareholders have tried to use proposals to influence pricing strategies, urging companies selling high-priced pharmaceuticals to exercise price restraint or to report on the effect of price surges on the companies’ bottom lines and long-term financial health.<sup>10</sup> Getting these proposals on the table was a triumph in itself, as pricing strategy proposals are generally excluded from proxy materials under a U.S. Securities and Exchange Commission (“SEC” or “Commission”) exception.<sup>11</sup> Yet, unfortunately for proponents, these proposals often fail.<sup>12</sup>

The key to a successful proposal lies in the advocacy power held by institutional shareholders. Such parties, though perhaps unresponsive to the social controversy surrounding the pricing of specialty and niche pharmaceutical drugs, may nevertheless have financial incentives to seek some level of price restraint on overpriced pharmaceutical products in order to protect their

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<sup>9</sup> Elise N. Rindfleisch, Note, *Shareholder Proposals: A Catalyst for Climate Change-Related Disclosure, Analysis, and Action?*, 5 BERKELEY BUS. L.J. 45, 57 (2008).

<sup>10</sup> See Eli Lilly and Co., SEC No-Action Letter, 1993 WL 54306, at \*1 (Feb. 25, 1993); Warner-Lambert Co., SEC No-Action Letter, 2000 WL 223668, at \*1 (Feb. 21, 2000).

<sup>11</sup> For the ordinary business exclusion, see Shareholder Proposals, 17 C.F.R. § 240.14a–8(i)(7) (2017). For examples of how this exclusion is used to omit pricing policy proposals, see Verizon Com. Inc., SEC No-Action Letter, 2016 WL 7384046, at \*1 (Dec. 16, 2016) (“There appears to be some basis for your view that Verizon may exclude the proposal under rule 14a–8(i)(7), as relating to Verizon’s ordinary business operations. In this regard, we note that the proposal relates to Verizon’s discount pricing policies.”). See also Ford Motor Co., SEC No-Action Letter, 2011 WL 96410, at \*1 (Jan. 31, 2011) (excluding a proposal under the ordinary business exclusion because, generally, the setting of prices for products and services is fundamental to management’s ability to run a company on a day-to-day basis).

<sup>12</sup> See *infra* Section III.A.2.

investments.<sup>13</sup> The self-interest of an institutional investor therefore helps resolve a social issue.<sup>14</sup> Without significant engagement and expenditure on the part of proponent shareholders, the victory of getting a proposal included in a company's proxy materials in the first place may backfire. A resubmission rule bars future similar proposals if prior proposals did not receive a threshold vote percentage, so unsuccessful attempts can impede future efforts.<sup>15</sup>

This Note argues that institutional shareholders, as a result of holding large blocs of stock in target companies and having the funds to widely circulate materials to shareholders and the media, are in the best position to unlock shareholder value by utilizing the shareholder proposal mechanism, but that the mechanism may ultimately prove unsuccessful without their engagement and expenditure. Specifically, through the shareholder proposal mechanism, institutional investors can pressure pharmaceutical companies to implement reasonable price restraint policies and consider and report on current pricing schemes' effects on their long-term financial health.<sup>16</sup> If institutional shareholders do not begin taking an active role, shareholders may lose access to the SEC-created carve-out for proposals relating to pharmaceutical prices due to the resubmission rule.<sup>17</sup>

Part II of this Note discusses the rise in pharmaceutical prices and summarizes the shareholder proposal rule as well

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<sup>13</sup> A company's long-term financial health may be negatively impacted by loss in market share, delayed product approvals, and damaged reputations among consumers and medical professionals, leading to shareholder losses which, with appropriate foresight, institutional investors may see coming and seek to alleviate by way of pricing modifications. *See infra* Section II.B.

<sup>14</sup> *See, e.g.*, UAW, Letter to Vertex, *supra* note 4.

<sup>15</sup> For more information on the resubmission rule, see *infra* Section II.C.4.

<sup>16</sup> For common forms that proposals for fair pricing of pharmaceutical products take, see *infra* Section III.A.1.

<sup>17</sup> *See infra* Section III.A.1.ii.

as the exceptions to that rule on which companies most frequently relied when seeking permission to omit shareholder proposals from their proxy materials and annual meetings. Part III evaluates previous shareholder proposals for pharmaceutical price restraint and discusses company and SEC responses to those proposals, including the impacts—both through the shareholder voting process and outside of it through institutional investors—of those proposals on company policy. Part IV considers the implications of this Note’s findings for the viability of shareholder proposals seeking to make drug price changes, calls on institutional investors to “use it or lose it” by actively leveraging the shareholder proposal mechanism, and suggests specific pension funds that may be properly incentivized to do so.

## II. BACKGROUND ON PHARMACEUTICAL PRICING AND SHAREHOLDER PROPOSALS

### A. Recent Developments in Pharmaceutical Pricing

With Americans currently spending upward of \$425 billion on prescription drugs each year,<sup>18</sup> pharmaceutical pricing is in the public spotlight. Prices often fluctuate wildly. One example, Novartis’ leukemia drug, was originally priced at \$24,000 per-patient upon approval by the Food and Drug Administration (“FDA”) but jumped to \$90,000 per-patient a decade later without explanation.<sup>19</sup> Some large pharmaceutical companies target pharmaceutical products for acquisition with a plan to substantially raise the cost to

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<sup>18</sup> Michelle Cortez, *Prescription Drug Spending Hits Record \$425 Billion in U.S.*, BLOOMBERG (Apr. 14, 2016, 12:00 AM), <https://www.bloomberg.com/news/articles/2016-04-14/prescription-drug-spending-hits-record-425-billion-in-u-s> [perma.cc/8HPT-SYMG].

<sup>19</sup> Lacie Glover, *Oncologists Worry About Rising Costs of Cancer Treatment*, U.S. NEWS & WORLD REP. (July 1, 2015, 10:41 AM), <http://health.usnews.com/health-news/patient-advice/articles/2015/07/01/oncologists-worry-about-rising-costs-of-cancer-treatment> [perma.cc/AV52-BK2R].

consumers for the same product post-acquisition.<sup>20</sup> Valeant Pharmaceuticals, for example, admitted to strategically acquiring pharmaceutical products where “a central premise was a planned increase in the prices of the medicines.”<sup>21</sup> After these acquisitions, Valeant raised the prices of some acquired drugs by hundreds of percentage points.<sup>22</sup>

## B. Negative Impacts of Current Prices

Even with insurance, patients pay hefty out-of-pocket treatment costs and rising premiums through which they become the primary bearers of the financial burden imposed by skyrocketing prices.<sup>23</sup> In order to maintain treatment regimens, patients often accumulate debt; cancer patients, for example, are 2.5 times more likely to file for bankruptcy than people who do not have cancer.<sup>24</sup> While there may be other factors influencing patients’ financial troubles, such as

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<sup>20</sup> Jonathan D. Rockoff & Ed Silverman, *Pharmaceutical Companies Buy Rivals’ Drugs, Then Jack Up the Prices*, WALL ST. J. (Apr. 26, 2015, 9:00 PM), <https://www.wsj.com/articles/pharmaceutical-companies-buy-rivals-drugs-then-jack-up-the-prices-1430096431> [perma.cc/9992-QLUD].

<sup>21</sup> Cynthia Koons & Anna Edney, *Ackman, Valeant Offer Apologies, Concessions at Drug Hearing*, BLOOMBERG (April 27, 2016, 5:58 PM), <https://www.bloomberg.com/news/articles/2016-04-27/valeant-s-regrets-may-not-appease-senators-at-drug-price-hearing> [perma.cc/7YYB-W9ZQ].

<sup>22</sup> Valeant’s product Nitropress rose by 525% in price. Isuprel rose 212%. See *Democrats on House Panel Attack Heart Drug Price Increases*, N.Y. TIMES (Sept. 28, 2015), <https://nyti.ms/1iXzGVq> [perma.cc/8UBB-LYUK].

<sup>23</sup> Insurance companies may absorb some of the financial burden of increasing drug prices; however, in addition to requiring patients to pay a percentage of the drug price (which may be dramatically increased at any time), many insurers also raise premiums in order to cover their rising costs, thus passing on the financial burden to their insured patients in multiple ways. Further, taxpayers as a whole “underwrite the cost of prescription drugs provided by Medicare, Medicaid and other public insurance programs.” Liz Szabo, *Skyrocketing Drug Prices Leave Cures out of Reach for Some Patients*, USA TODAY (Jan. 6, 2016, 5:28 PM), <http://www.usatoday.com/story/news/2015/06/14/rising-drug-prices/71077100> [perma.cc/Y7U7-Y73H].

<sup>24</sup> Szabo, *supra* note 23.

job loss or the inability to work while receiving treatment, cancer treatment has become so expensive that it presents an unmistakable hurdle to the average person. New cancer drugs are “routinely” priced at over \$100,000 per year, which is nearly twice the average household income.<sup>25</sup> Such burdensome costs often lead patients to either risk their financial wellbeing in order to receive the recommended treatment or risk their physical wellbeing by “rationing” their treatments to reduce costs.<sup>26</sup>

In addition to being a financial burden, rising prices create negative externalities for patient access, leading to direct impacts on healthcare quality. Some patients are denied access to expensive but highly effective drugs by their insurance carriers.<sup>27</sup> For example, Sovaldi, which was approved by the FDA in 2013, has been shown to cure 90% of chronic hepatitis C patients within twelve weeks, and yet, because of its \$1000 per-pill price, many Medicaid programs are “sharply restricting access” to the drug and “offering it only to the sickest patients.”<sup>28</sup>

Medical professionals have begun to censure companies for their pharmaceutical pricing schemes.<sup>29</sup> Memorial Sloan-

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<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> Jake Harper, *States Deny Pricey Hepatitis C Drugs to Most Medicaid Patients*, NPR (Dec. 27, 2015, 5:32 AM), <http://www.npr.org/sections/health-shots/2015/12/27/460086615/states-deny-pricey-hepatitis-c-drugs-to-most-medicare-patients> [perma.cc/VX4Z-K9ND]; Olga Khazan, *The True Cost of an Expensive Medication*, ATLANTIC (Sept. 25, 2015), <https://www.theatlantic.com/health/archive/2015/09/an-expensive-medications-human-cost/407299> [perma.cc/XVE4-9CEV].

<sup>28</sup> Szabo, *supra* note 23.

<sup>29</sup> Ed Silverman, *Cancer Doctors Raise Pressure on Pharma Industry to Cut Drug Prices*, FORBES (Apr. 25, 2013), <https://www.forbes.com/sites/edsilverman/2013/04/25/cancer-doctors-raise-pressure-on-pharma-industry-to-cut-drug-prices/#2174f1c3d156> [https://perma.cc/B6QH-A4Y2]; Ayalew Tefferi et al., *In Support of a Patient-Driven Initiative and Petition to Lower the High Price of Cancer Drugs*, 90 MAYO CLINIC PROCEEDINGS 996, 996–1000 (Aug. 2015), <http://www.mayoclinic>

Kettering Cancer Center refused to continue prescribing a cancer drug that cost over twice as much as a similarly effective medicine offered by another company.<sup>30</sup> Medicaid programs have begun to deny coverage of some high-priced drugs.<sup>31</sup> While this response by medical professionals and insurance institutions may be motivated by a desire to pressure pharmaceutical companies to lower prices, it also further impairs patient access to otherwise beneficial treatment by proscribing use of certain medications.

### 1. Possible Explanations for Price Increases

Several factors may contribute to the rise in prescription medication prices. Explanations often draw upon the significant investment in research and development (“R&D”) that is needed to discover, test, and manufacture drugs to meet existing medical needs.<sup>32</sup> Drug executives often say that bringing a new drug to market costs a company \$2.6

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[proceedings.org/article/S0025-6196%2815%2900430-9/fulltext](http://proceedings.org/article/S0025-6196%2815%2900430-9/fulltext) [<https://perma.cc/HQ4U-A5WP>].

<sup>30</sup> Peter B. Bach et al., *In Cancer Care, Cost Matters*, N.Y. TIMES (Oct. 14, 2012) <http://www.nytimes.com/2012/10/15/opinion/a-hospital-says-no-to-an-11000-a-month-cancer-drug.html> [<https://perma.cc/9WFX-X3Z7>] (stating that costs for Zaltrap averaged \$11,063 per month).

<sup>31</sup> Joseph Walker, *Costly Vertex Drug Is Denied, and Medicaid Patients Sue*, WALL ST. J. (July 16, 2014, 10:30 PM), <http://www.wsj.com/articles/costly-drug-vertex-is-denied-and-medicaid-patients-sue-1405564205> [[perma.cc/WJR9-PF9H](https://perma.cc/WJR9-PF9H)] (stating that Arkansas Medicaid officials denied cystic-fibrosis patients access to medication because of its cost); Harper, *supra* note 27 (stating that Indiana Medicaid denied coverage of highly effective Hepatitis C medication and that Medicaid in at least thirty-four states generally does not pay for the treatment unless the patient has already demonstrated significant liver damage).

<sup>32</sup> See Matthew S. Openshaw, *The Economics of Prescription Drug Prices, Government Intervention and the Importation of Drugs from Canada*, 23 NURS. ECON. J. 307, 307–11 (2005), <http://www.medscape.com/viewarticle/521378> [<https://perma.cc/6K24-P824>].

billion and takes ten-to-fifteen years.<sup>33</sup> Pharmaceutical prices may reflect those financial and time investments.

Patent protection, which incentivizes companies to make up-front R&D investments by providing temporary monopoly power to patented drugs, may contribute to high pharmaceutical prices.<sup>34</sup> When a company holds the patent rights to a new medication, there is no competition from other drugs with the same composition, meaning “there is no downward pressure on the price from other potential drug suppliers.”<sup>35</sup> This system may allow the patent holder to set its own price, but in doing so encourages R&D investment.<sup>36</sup> It should be noted, however, that while patent protection may explain high prices of newly patented medications, it may not explain subsequent price increases for those medications (whether raised by the original patent holder or by a company that purchased the patent from the original holder) or price increases for generic medications.<sup>37</sup>

Companies may also price their drugs to reflect total R&D cost, including compensation for both investments in market-ready medications and losses on investments in previous medications that failed to receive FDA approval. Companies seeking approval from the FDA must test new drugs in a series of clinical trials, each time requiring approval from an

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<sup>33</sup> Amy Nordrum, *Why Are Prescription Drugs So Expensive? Big Pharma Points to the Cost of Research and Development, Critics Say That's No Excuse*, INT'L BUS. TIMES (May 19, 2015, 11:59 AM), <http://www.ibtimes.com/why-are-prescription-drugs-so-expensive-big-pharma-points-cost-research-development-1928263> [<https://perma.cc/S566-M5WV>] (the article notes that critics are wary of the explanation given by drug company executives).

<sup>34</sup> Openshaw, *supra* note 32.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> However, it should be noted that even when a company does purchase a medication post-approval, it may pay a premium for it, particularly if the medication is still under patent protection. *See* Richard L. Fuller & Norbert Goldfield, *Paying for On-Patent Pharmaceuticals: Limit Prices and the Emerging Role of a Pay for Outcomes Approach*, 39 J. AMBULATORY CARE MGMT. 143, 144 (2016).

institutional review board to proceed to the next phase.<sup>38</sup> The criteria for permission to proceed with clinical trials differs by phase, but generally involves a review of the drug's safety and effectiveness.<sup>39</sup> Even after reaching early stage Phase I clinical trials, only one out of ten drugs is permitted to proceed through Phase 3 clinical trials and finally receives FDA approval.<sup>40</sup> Because of the difficulty in obtaining approval through this process, the average pharmaceutical product in development is unlikely to create an ongoing revenue stream. With this in mind, companies may seek compensation for development risk associated with the marketed drug or wish to offset previous development losses on unsuccessful drugs that were precursors of the successful drug. Many companies argue that their pricing schemes reflect the "high price tags . . . [of] the costs and effort of developing the drugs."<sup>41</sup> Boards of directors of pharmaceutical companies rely on this argument when urging shareholders to vote against proposals seeking price restraint and reporting.<sup>42</sup>

## 2. Shareholder Motivations

Shareholders seeking price restraint may have divergent motivations. First, shareholders may be motivated by the desire to protect the interests of healthcare consumers and

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<sup>38</sup> U.S. FOOD & DRUG ADMINISTRATION, *The FDA's Drug Review Process: Ensuring Drugs are Safe and Effective* (Nov. 11, 2014), <https://www.fda.gov/Drugs/ResourcesForYou/Consumers/ucm143534.htm> [<https://perma.cc/TXH5-54VD>].

<sup>39</sup> *Id.*

<sup>40</sup> Bill Berkot, *Success Rates for Experimental Drugs Fall: Study*, REUTERS (Feb. 14, 2011, 8:09 AM), <http://www.reuters.com/article/us-pharmaceuticals-success-idUSTRE71D2U920110214> [<https://perma.cc/K4AW-2V5M>].

<sup>41</sup> Walker, *supra* note 31.

<sup>42</sup> See Celgene Corp., Definitive Proxy Statement (Form 14A) (Apr. 30, 2015).

the stability of the industry.<sup>43</sup> The UAW Retiree Medical Benefits Trust (“UAW”), in its letter to the SEC regarding Gilead’s request for an SEC no-action letter (“no-action letter”),<sup>44</sup> noted concerns regarding “actual and potential responses by payers and prescribers,” “the impact of high prices on patient access,” and “the financial sustainability of the broader health care system.”<sup>45</sup> A group of institutional investors recently called on seventeen drug companies to increase price transparency due to concerns that rising costs make it difficult for patients to access prescription drugs.<sup>46</sup> These motivations sound in concerns for patients who lack access to medication or who experience financial distress because of the cost of medication, as well as concern for the stability of the pharmaceutical industry as a whole.

Second, there may be a financial incentive for price restraint: higher returns in the long run. Meredith Miller, Chief Corporate Governance Officer at UAW, said of the trust’s shareholder proposals that the trust was “looking out for [its] long-term interests and investments.”<sup>47</sup> If a pharmaceutical company’s stock value is depressed because of issues that stem from its pricing policies, shareholders

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<sup>43</sup> Dave Barkholz, *Institutional Investors Fight for More Sway at Healthcare Companies*, MODERN HEALTHCARE (May 14, 2016), <http://www.modernhealthcare.com/article/20160514/magazine/305149981> [<https://perma.cc/YD79-MEKD>].

<sup>44</sup> In this instance, UAW submitted a shareholder proposal to Gilead. In response, Gilead asked the SEC to issue a no-action letter that would allow Gilead to omit the proposal from its proxy voting materials. For more information on the shareholder proposal process and an explanation of no-action letters, see *infra* Section III.B.

<sup>45</sup> Gilead Sciences, Inc., SEC No-Action Letter, 2014 WL 6984699, at \*3 (Jan. 22, 2015).

<sup>46</sup> Peter Loftus, *Faith-Based Investor Group Calls for Drugmakers to Be Transparent on Pricing*, WALL ST. J. (Oct. 24, 2016, 4:07 PM), <https://www.wsj.com/articles/faith-based-investor-group-calls-for-drugmakers-to-be-transparent-on-pricing-1477317600> [<https://perma.cc/AZ6B-RRYH>].

<sup>47</sup> See Barkholz, *supra* note 43.

may be motivated to restore that value by submitting proposals to the board.

Loss in market share, delayed product approvals, and damaged reputations among consumers and medical professionals all contribute to shareholder losses. A shareholder support letter accompanying a shareholder's pricing proposal to Celgene Corporation noted that, after the drug Revlimid rose in cost from \$8500 per year in 2010 to \$156,000 per year in 2014, the company encountered "difficulties in obtaining coverage for Revlimid . . . without price concessions" and was likely to continue struggling because of the cost of the drug.<sup>48</sup> The shareholder proposal to Vertex cited tangible impacts of the company's pricing strategy, noting that Arkansas' Medicaid program denied coverage of the company's cystic-fibrosis drug "because of its cost," leading the company to lose revenue that would have come from Medicaid patients.<sup>49</sup> The drug's cost also caused the company to face price pushback in the United Kingdom and Canada, leading to eighteen-month approval delays.<sup>50</sup>

Such setbacks, and the public image problems that may accompany them, often correlate with a change in stock value. After an extended period during which Valeant acquired pharmaceutical products and systematically increased prices, the outgoing CEO told the Senate that Valeant's price hikes were a mistake;<sup>51</sup> amid investigation and controversy surrounding its drug pricing, Valeant lost more than 85% of its stock market value.<sup>52</sup> As a Valeant shareholder, activist investor Bill Ackman's recommendation for returning shareholder value was to "reduce the prices of those drugs" and begin using "socially responsible pricing" so

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<sup>48</sup> Celgene Corp., SEC No-Action Letter, 2015 WL 496500, at \*8 (Mar. 19, 2015).

<sup>49</sup> See UAW, Letter to Vertex, *supra* note 4.

<sup>50</sup> See UAW, Letter to Vertex, *supra* note 4.

<sup>51</sup> See Hoffman & Rapoport, *supra* note 7.

<sup>52</sup> See Koons & Edney, *supra* note 21.

that “all hospitals could have access.”<sup>53</sup> Similarly, when a large pharmacy benefit manager refused to continue covering some of Gilead Pharmaceuticals’ high-priced specialty drugs, the company’s stock price took a 17% plunge.<sup>54</sup>

Board members owe a fiduciary duty to shareholders<sup>55</sup> and, while they will not be scrutinized with regard to most business decisions, their decisions must still be reasonable and include consideration of the shareholders to which they are fiduciaries.<sup>56</sup> Thus, shareholders may expect to have recourse to the board when they believe pricing policies are to blame for stock losses.

### C. Mechanics of a Shareholder Proposal: Rule 14a-8

When shareholders are motivated to adjust a company’s policies, one tool for change is Rule 14a-8: the town meeting rule. Section 14 of the Securities Exchange Act of 1934, regulated by the SEC, governs proxy materials of publicly-held companies, permitting shareholders to put forth proposals for proxy voting.<sup>57</sup> Provided that the proposal does not violate any of the SEC’s proxy rules, a shareholder who

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<sup>53</sup> *Id.*

<sup>54</sup> Gilead Sciences Inc. (Form PX14A6G) (Apr. 28, 2015).

<sup>55</sup> *Meinhard v. Salmon*, 249 N.Y. 458, 463–64 (1928). This reference comes from a joint venture rather than a corporation; however, it has been used to describe the fiduciary relationships between parties in trusts, partnerships, and corporations, and thus courts have implicitly recognized that a fiduciary duty has the same general nature, regardless of where it is found. See also *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (discussing directors’ fiduciary duty of care); *In re Caremark Intl Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (discussing directors’ fiduciary duty of care); *Unocal Corp. v. Mesa Petroleum Co.* (discussing enhanced fiduciary duties to ensure a board is not acting primarily in its own interests); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (discussing fiduciary duties where the sale or break-up of a company is inevitable).

<sup>56</sup> John C. Carter, *The Fiduciary Rights of Shareholders*, 29 WM. & MARY L. REV. 823, 847 (1988).

<sup>57</sup> Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2017).

meets minimum requirements is entitled to inclusion of his or her proposal in a company's proxy materials and a vote on the proposal at the company's annual meeting.<sup>58</sup> At a minimum, the shareholder must have continually owned either \$2000 in market value of the company's securities or 1% of the company's voting securities for at least one year by the date of submission;<sup>59</sup> the proposal must be introduced as a resolution; and only one proposal may be introduced per shareholder at the shareholders' meeting, at which the proponent shareholder must be present.<sup>60</sup> Shareholder proposals typically fall into one of two categories: Corporate Governance Proposals that relate to governance issues such as board structure, compensation disclosure, and director election; and Corporate Social Responsibility Proposals ("CSR Proposals"), including pharmaceutical pricing proposals, which relate to social motivations and are "designed to try to change corporate behavior in a way the proponent believes would be socially beneficial."<sup>61</sup>

Within Rule 14a-8, the SEC provides exceptions that allow a company to omit the proposal from their proxy materials. These "exclusions" apply to proposals that (1) are not a "proper subject" for shareholder action under state law, (2) are not "significantly related" to the business of the company, (3) relate to the company's "ordinary business operations," (4) relate to the specific amount of dividends, (5) relate to director or officer elections, (6) directly conflict with a management proposal, (7) duplicate another proposal already included in the proxy materials, (8) are substantially similar to another proposal submitted over the past five years, (9) would require the company to violate a law if passed, (10) are contrary to the SEC proxy rules, (11) relate to a personal claim or grievance, (12) are beyond the

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<sup>58</sup> *Id.*

<sup>59</sup> 17 C.F.R. § 240.14a-8(b)(1).

<sup>60</sup> 17 C.F.R. § 240.14a-8(h)(1).

<sup>61</sup> WILLIAM T. ALLEN & REINER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 211 (5th ed. 2016).

company's power to effect, or (13) have been rendered moot by the company already substantially implementing that which is proposed by the shareholder.<sup>62</sup> This Note will further address the three exclusions most frequently relied upon in pharmaceutical pricing proposals: (1) the ordinary business operations exclusion, (2) the mootness due to substantial implementation exclusion, and (3) the substantially similar to another proposal exclusion.

### 1. Utilizing an Exclusion: SEC No-Action Letters

When company management receives a shareholder proposal, they often wish to omit it from their annual meeting. In this instance, the company must notify the shareholder and give them fourteen days to amend their proposal.<sup>63</sup> If, after that period, the company still wishes to exclude the proposal, it must submit to the SEC a copy of the proposal along with any supporting statements by the shareholder and a letter explaining the grounds on which the company intends to omit it.<sup>64</sup> If the SEC staff ("Staff") agrees with the company that the proposal may be properly omitted, it will issue a no-action letter in which an "authorized staff official indicates that the Staff will not recommend any enforcement action to the Commission if the proposed transaction described in the incoming correspondence is consummated."<sup>65</sup> If the Staff disagrees with the company, it may state in its response (also called a no-action letter) that it is "unable to assure the writer that [it] will not recommend enforcement action to the Commission if the transaction

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<sup>62</sup> 17 C.F.R. § 240.14a-8(i).

<sup>63</sup> 17 C.F.R. § 240.14a-8(f).

<sup>64</sup> SEC Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals, Release No. 9344, 1976 WL 160411, at \*2 (July 7, 1976); SEC Division of Corporation Finance: Staff Legal Bulletin No. 14, 2001 WL 34886112, at \*2 (July 13, 2001); 17 C.F.R. § 240.14a-8(j)(2).

<sup>65</sup> Procedures Utilized by the Div. of Corp. Fin. for Rendering Informal Advice, Release No. 6253, 1980 WL 25632, at \*1 n.2 (Oct. 28, 1980).

occurs in the manner proposed by the writer.”<sup>66</sup> Without having demonstrated that the proposal falls under an omission exclusion, the company should, and commonly does, include the proposal in its proxy materials.<sup>67</sup>

No-action letters are generally not subject to judicial review, and thus the letters themselves are the strongest indicator of how Rule 14a-8 has been interpreted over time.<sup>68</sup> Section 26 of the Securities Exchange Act of 1934 gives federal courts jurisdiction over suits “brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.”<sup>69</sup> If a company refuses to include a proposal in its proxy materials, despite a no-action letter to the contrary, a court may grant review in order to determine the appropriate remedy for the proponent shareholder.<sup>70</sup> In such instances, the company bears the burden of “establishing as a matter of law that it properly excluded the

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<sup>66</sup> *Id.*

<sup>67</sup> 17 C.F.R. § 240.14a-8; John G. Matsusaka et. al., *Why Do Managers Fight Shareholder Proposals? Evidence from SEC No-Action Letter Decisions* 7 (USC Ctr. for Law & Soc. Sci., Research Paper No. CLASS17-4, 2017), <https://ssrn.com/abstract=2881408>.

<sup>68</sup> See Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 945 (1998) (“[T]he availability of judicial review depends on whether the Commission reviewed and approved the particular no-action letter. In cases where the Commission has refused to review a no-action letter issued by the staff, direct judicial review under either the federal securities statutes’ review provisions or the APA is generally foreclosed because there is no final agency action to review.”); *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 258 (2d. Cir. 1994) (denying judicial review of an SEC no-action letter); *Kixmiller v. SEC*, 492 F.2d 641, 643–44 (D.C. Cir. 1974) (finding no jurisdiction to review staff decisions stated in no-action letters which have not been examined by the Commission and where the Commission has not expressed a view of its own).

<sup>69</sup> See *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores*, 821 F. Supp. 877, 879 n.1 (S.D.N.Y. 1993).

<sup>70</sup> See *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 331, 334 (3d Cir. 2015).

proposal under an exception to Rule 14a-8.”<sup>71</sup> Rule 14a-8 has also been at issue in court where shareholders who sensed that the company would not abide by an SEC mandate to include their proposal sued proactively to enjoin the company from issuing proxy materials without it.<sup>72</sup> Such suits represent shareholder attempts to enforce SEC no-action letters, as opposed to attempts to challenge them, although a company may attempt to challenge the SEC’s decision by refusing to abide by a no-action letter and then trying to prove its own interpretation of Rule 14a-8 in court. However, if a company were to pursue this strategy, it may be unable to rely on previous SEC no-action letters to make its arguments. Because the Staff’s advice in no-action letters is “informal and nonjudicial in nature, it does not have precedential value” and generally cannot be used to challenge “identical or similar proposals submitted . . . in the future.”<sup>73</sup>

## 2. The Ordinary Business Exclusion

Rule 14a-8 creates an exclusion for shareholder proposals dealing with “ordinary business operations” or decisions that company management should make.<sup>74</sup> There has been significant debate regarding what falls under the ordinary business decision exclusion; in fact, the Third Circuit noted that the exclusion “has been called the ‘most perplexing’ of all the 14a-8 bars.”<sup>75</sup> Yet the exclusion served as the grounds of decision for 18% of all no-action relief grants in 2013 and for 55.9% of all no-action relief grants in 2016.<sup>76</sup> The SEC

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<sup>71</sup> *Id.* at 334.

<sup>72</sup> *Amalgamated Clothing*, 821 F. Supp. at 879.

<sup>73</sup> Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals, *supra* note 64, at \*5.

<sup>74</sup> 17 C.F.R. § 240.14a-8(i)(7) (2017).

<sup>75</sup> *Trinity Wall St.*, 792 F.3d at 337.

<sup>76</sup> See GIBSON DUNN & CRUTCHER LLP, SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2013 PROXY SEASON 2 (July 9, 2013), <http://www.gibsondunn.com/publications/Documents/Shareholder-Proposal>

makes decisions as to what constitutes “ordinary business” on a case-by-case basis.<sup>77</sup> Two factors, though not dispositive, are regularly considered by the SEC in determining whether a proposal falls under ordinary business. First, the Staff considers the subject matter of the proposal and asks whether the subject relates to ordinary business operations.<sup>78</sup> Tasks that are “fundamental to management’s ability to run a company on a day-to-day basis,” such as “the hiring, promotion, and termination of employees, decisions on production quality and quantity, and the retention of suppliers,” will generally fall within the meaning of “ordinary business operations.”<sup>79</sup> Second, if the subject matter does fall within the ordinary business category, the Staff will consider the extent to which the proposal seeks to “micromanage” the corporation.<sup>80</sup> Micromanagement is typically found where a proposal “seeks intricate detail” or imposes “specific time-frames or methods for implementing complex policies.”<sup>81</sup>

Proposals related to ordinary business operations under these factors can still survive and appear in proxy materials if they are deemed to “include certain matters which have significant policy, economic or other implications inherent in them.”<sup>82</sup> A mere mention of a significant social policy issue is

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-Developments-2013-Proxy-Season.pdf [<https://perma.cc/M34D-PDHF>]; see also GIBSON DUNN & CRUTCHER LLP, SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2016 PROXY SEASON 16 (June 28, 2016), <http://www.gibsondunn.com/publications/Documents/Shareholder-Proposal-Developments-2016-Proxy-Season.pdf> [<https://perma.cc/NSK5-Z8UE>].

<sup>77</sup> ALLEN & KRAAKMAN, *supra* note 61, at 212–13.

<sup>78</sup> *Id.* at 213.

<sup>79</sup> *Trinity Wall St.*, 792 F.3d at 339–40 (quoting Amendments to Rules on Shareholder Proposals, SEC Release Nos. 34-39093, IC-22828, 1997 SEC LEXIS 1962, at \*49 (proposed Sept. 18, 1997)).

<sup>80</sup> ALLEN & KRAAKMAN, *supra* note 61, at 213–14.

<sup>81</sup> 1997 SEC LEXIS 1962, *supra* note 79, at \*50.

<sup>82</sup> *Adoption of Amendments Relating to Proposals by Security Holders*, 41 Fed. Reg. 52,994, 52,998 (Dec. 3, 1976) (codified at 17 C.F.R. pt. 240) (hereinafter 1976 Rule 14a-8 Amendments).

normally not enough; the policy issue must “transcend” ordinary business operations in order to be considered safe from the ordinary business exclusion.<sup>83</sup> In contrast, proposals referring to ordinary business matters that are “mundane in nature” and do not implicate “any substantial policy considerations” can almost certainly be omitted from proxy materials.<sup>84</sup> What the SEC considers a substantial policy consideration, however, has evolved with time.<sup>85</sup> Proposals related to issues that were once excludable under the ordinary business exception are non-excludable where the social policy issues they raise have become more significant.<sup>86</sup> For example, issues of whether to close or relocate a company facility were once excludable; however, the Staff now considers proposals non-excludable where there is a focus on studying effects of closing company facilities on the surrounding communities.<sup>87</sup>

The SEC has historically viewed proposals for pricing modifications and structures as part of a company’s “management functions,” which could be omitted under 17 C.F.R. 240.14a-8(c)(7).<sup>88</sup> This has not been true, however, within the pharmaceutical industry.<sup>89</sup>

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<sup>83</sup> *Trinity Wall St.*, 792 F.3d at 341.

<sup>84</sup> 1976 Rule 14a-8 Amendments, 41 Fed. Reg. at 52,998.

<sup>85</sup> Joseph A. Roy, Note, *Non-Traditional Activism: Using Shareholder Proposals to Urge LGBT Non-Discrimination Protection*, 74 BROOK. L. REV. 1513, 1529 (2009).

<sup>86</sup> Reebok Int’l Ltd., SEC No-Action Letter, 1992 WL 55815, at \*1 (Mar. 16, 1992); Transamerica Corp., SEC No-Action Letter, 1990 WL 285806, at \*1 (Jan. 10, 1990); Pacific Telesis Group, SEC No-Action Letter, 1989 WL 245523, at \*1 (Feb. 2, 1989).

<sup>87</sup> See Pacific Telesis Group, *supra* note 86, at \*1.

<sup>88</sup> See, e.g., UnitedHealth Group Inc., SEC No-Action Letter, 2011 WL 318086, at \*17 (Mar. 16, 2011); see also Pacific Telesis Group, *supra* note 86, at \*1.

<sup>89</sup> See *infra* Section III.A.1.i.

### 3. The Substantially Implemented Exclusion

Second, a company may omit a shareholder proposal from its proxy statements and annual meeting if it has already “substantially implemented” the proposal. According to the Commission, this exclusion aims “to avoid the possibility of shareholders having to consider matters which have already been favorably acted upon by the management.”<sup>90</sup> This rule served as grounds for 30.9% of all no-action relief grants in 2016.<sup>91</sup>

The Commission’s construction of this rule has evolved and broadened over time. In its early use, the Staff only granted no-action relief under this exclusion if the company had “fully effected” the shareholder proposal.<sup>92</sup> Later, understanding that such a “formalistic application” of the exclusion “defeated its purpose” because shareholders could introduce proposals that differed by just a few words, the Commission revised its interpretation.<sup>93</sup> At this point, the Commission began interpreting the rule in a way that omitted only proposals which had been so “substantially implemented” that they should be excluded as moot.<sup>94</sup>

More recently, the standard has been whether a company’s policies, practices, and procedures “compare favorably with the guidelines of the proposal.”<sup>95</sup> For a company to legally omit a proposal, it must demonstrate that

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<sup>90</sup> See Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 12598, 1976 WL 160410, at \*9 (July 7, 1976).

<sup>91</sup> See GIBSON DUNN & CRUTCHER LLP 2016, *supra* note 76, at 16.

<sup>92</sup> See Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 19135, 1982 WL 600869, at \*17 (Oct. 14, 1982).

<sup>93</sup> See Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20091, 1983 WL 33272, at \*7 (Aug. 16, 1983).

<sup>94</sup> *Id.*

<sup>95</sup> See Lowe’s Cos., SEC No-Action Letter, 2008 WL 308197, at \*2 (Jan. 29, 2008); Exxon Mobil Co., SEC No-Action Letter, 2016 WL 343257, at \*1 (Mar. 22, 2016).

its actions compare favorably with (a) the shareholder proposal's "underlying concerns" and (b) the shareholder proposal's essential elements.<sup>96</sup> The Staff permits differences between company action and the action requested in a shareholder proposal as long as the company action addresses the proposal's "essential objective."<sup>97</sup>

#### 4. The Resubmission Exclusion

Third, a company may omit a shareholder proposal if it "deals with substantially the same subject matter as another proposal . . . [that was] previously included in the company's proxy materials" in the last five calendar years and received a sufficiently low vote.<sup>98</sup> If there was only one previous proposal, the company will exclude a substantially similar proposal if the prior proposal received less than 3% of the vote at the annual meeting.<sup>99</sup> If the subject matter was proposed twice within the past five years, a new proposal will be omitted if the previous vote garnered less than 6% of the vote.<sup>100</sup> If the matter was proposed three times, the new proposal will only survive if the last submission received at least 10% of the vote.<sup>101</sup> As a result, every shareholder vote on a proxy proposal risks a bar on raising a similar proposal for a certain number of years in the future. Thus, the format and success of each proposal can have a crucial impact on future proposals.

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<sup>96</sup> See Exelon Corp., SEC No-Action Letter, 2010 WL 4922472, at \*4 (Feb. 26, 2010).

<sup>97</sup> See Hewlett-Packard Co., SEC No-Action Letter, 2007 WL 4328654, at \*3 (Dec. 11, 2007). A proposal requesting a shareholder right to call a special meeting was substantially implemented by a proposed bylaw amendment permitting shareholders to do so unless the board determined that the specific issue to be addressed had already been dealt with or would soon be considered at an annual meeting. *See id.*

<sup>98</sup> 17 C.F.R. § 240.14a-8(I)(12) (2017).

<sup>99</sup> *Id.* § 240.14a-8(I)(12)(i).

<sup>100</sup> *Id.* § 240.14a-8(I)(12)(ii).

<sup>101</sup> *Id.* § 240.14a-8(I)(12)(iii).

### III. ANALYSIS OF SHAREHOLDER PROPOSAL SUCSESSES AND FAILURES

#### A. Shareholder Proposals Within the Pharmaceutical Industry

Shareholder proposals related to pharmaceutical pricing often take one of two forms. First, some proposals directly ask a company's board to adopt a policy of price restraint.<sup>102</sup> For example, a shareholder proposal to Warner-Lambert asked the company's board to "create and implement a policy of price restraint on pharmaceutical products for individual consumers and institutional purchasers to keep drug prices at reasonable levels."<sup>103</sup> Similarly, shareholders submitted a proposal to Eli Lilly requesting that the Board "seek input on pricing policy from consumer groups, *and adopt a policy of price restraint . . .*"<sup>104</sup> A proposal to Bristol-Myers Squibb asked its board to "create and implement a policy of price restraint on pharmaceutical products for individual customers and institutional purchasers, utilizing a combination of approaches to keep drug prices at reasonable levels."<sup>105</sup>

A second approach, used with more frequency in recent years, asks the board to report on pricing strategies and the impact of alleged price gouging on the company's current and long-term financial health. Celgene Corporation's shareholders submitted a proposal asking the board to "report to shareholders . . . on the risks to Celgene from rising pressure to contain U.S. specialty drug prices."<sup>106</sup> The

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<sup>102</sup> Eli Lilly, *supra* note 10, at \*1; Warner-Lambert, *supra* note 10, at \*1.

<sup>103</sup> Warner-Lambert, *supra* note 10, at \*7.

<sup>104</sup> Eli Lilly, *supra* note 10, at \*4 (emphasis added).

<sup>105</sup> Bristol-Myers Squibb Co., SEC No-Action Letter, 2000 WL 223744, at \*2 (Feb. 21, 2000).

<sup>106</sup> See Celgene Corp., Definitive Proxy Statement, *supra* note 42, at 82 ("Specialty drugs, as defined by the Center for Medicare and Medicaid Services, are those that cost more than \$600 per month.").

report was to address the risks created by “public concern that U.S. patients and payers are shouldering an excessive proportion of the cost burden;” the “[p]rice sensitivity of prescribers, payers, and patients;” and the “relationship between Celgene’s specialty drug prices and . . . benefit, patient access, . . . efficacy and price of alternative therapies, manufacturing costs, drug development costs, and the proportion of drug development costs borne by academic institutions and/or the government.”<sup>107</sup> Similarly, the Bristol-Myers Squibb proposal asked the Board to “report to shareholders . . . on changes in policies and pricing procedures for pharmaceutical products.”<sup>108</sup> A Vertex proposal asked for a “report to shareholders . . . at reasonable cost and omitting confidential or proprietary information, on the risks to Vertex from rising pressure to contain U.S. specialty drug prices,” including a focus on “price sensitivity of prescribers, payers and patients” and the “efficacy and price of alternative therapies, drug development costs, and the proportion of those costs borne by academic institutions, foundations and/or the government.”<sup>109</sup> While these particular proposals did not receive sufficient votes to pass,<sup>110</sup> it should be noted that, outside of the pharmaceutical industry, some proposals asking for reporting on national, environmental, or social issues did manage to achieve majority support in 2016.<sup>111</sup>

Using this second approach, shareholder proposals focus on obtaining enough information through reporting requirements for shareholders and investors to evaluate the

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<sup>107</sup> *Id.*

<sup>108</sup> Bristol-Myers Squibb, *supra* note 105, at \*2.

<sup>109</sup> Vertex Pharmacy Inc., SEC No-Action Letter, 2015 WL 109832, at \*13 (Feb. 25, 2015).

<sup>110</sup> *See infra* Section III.A.2.

<sup>111</sup> *See* GIBSON DUNN & CRUTCHER LLP 2016, *supra* note 76, at 37 (“A proposal requesting a report on methane emissions submitted to WPX Energy, Inc. received 50.8% of votes cast [and a] proposal requesting a sustainability report submitted to CLARCOR Inc. received 60.8% of votes cast.”).

financial health of the company in light of pricing-related business setbacks. Proposals do not have to take only one form, and some proposals utilize both approaches in unison, such as the Bristol-Myers Squibb proposal.<sup>112</sup>

## 1. SEC Treatment of Fair Pricing Proposals

### i. The Ordinary Business Carve-out for “Fundamental Business Strategy”

The SEC generally finds proposals related to pricing modifications and strategies to fall within a company’s ordinary business decisions, thus warranting omission by the company under the ordinary business exclusion.<sup>113</sup> However, the Staff has diverged from this trend with regard to pricing policies for *pharmaceutical products*, particularly when proposals were framed as national health issues facing the pharmaceutical industry and public at large.<sup>114</sup>

For example, the Eli Lilly proposal asked the board to seek input on its pricing policy from consumer groups and to adopt a policy of price restraint.<sup>115</sup> This proposal framed pricing fairness and restraint as a “crucial national issue” and the “key issue facing the pharmaceutical industry.”<sup>116</sup> The Eli Lilly proposal cited evidence from the Senate Special Committee on Aging, which conducts oversight of the administration of major programs such as Medicare and evaluates issues related to health and aging, including pricing practices for prescription drugs.<sup>117</sup> Warner-Lambert shareholders also put forth a proposal asking the board to

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<sup>112</sup> Bristol-Myers Squibb, *supra* note 105, at \*1–2.

<sup>113</sup> UnitedHealth Group, *supra* note 88, at \*1.

<sup>114</sup> See Eli Lilly, *supra* note 10, at \*1; Warner-Lambert, *supra* note 10, at \*1.

<sup>115</sup> Eli Lilly, *supra* note 10, at \*1.

<sup>116</sup> *Id.*; see also *History*, SENATE SPECIAL COMMITTEE ON AGING <http://www.aging.senate.gov/about/history> [<https://perma.cc/UA35-G92G>] (last visited June 3, 2017).

<sup>117</sup> See Eli Lilly, *supra* note 10, at \*5–6.

implement a policy of price restraint on pharmaceutical products for individual customers and institutional purchasers in order to keep drug prices at reasonable levels.<sup>118</sup> Upon requests for no-action from the respective companies, the SEC found that both proposals went beyond ordinary business decisions, going so far as to characterize the proposal by Warner-Lambert shareholders as affecting the company's "fundamental business strategy," and thus forced the companies to include the proposals in their proxy materials.<sup>119</sup>

Definitive interpretation of the phrase "fundamental business strategy" is scarce. Holly J. Gregory, Partner at Sidley Austin LLP, refers to the rule as a "carveout from the ordinary business exclusion to prevent exclusion of the proposals relating to pricing policies for the company's products."<sup>120</sup> In *Roosevelt v. E.I. DuPont de Nemours & Co.*,<sup>121</sup> the D.C. Circuit Court of Appeals held that the phrase "fundamental business strategy" involved questions of the company's "long-term goals."<sup>122</sup> According to the SEC, "when a shareholder proposal involves fundamental business strategy, long-term goals and economic orientation, the subject matter of the proposal would not be considered ordinary business subject to the exclusion under Rule 14a-8(c)(7)."<sup>123</sup>

It is unclear whether the fundamental business strategy carve-out applies outside of the pharmaceutical industry. Shareholders have used the same line of argument in other industries to no avail. But the SEC's responses do not state

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<sup>118</sup> Warner-Lambert, *supra* note 10, at \*1.

<sup>119</sup> Eli Lilly, *supra* note 10, at \*1; Warner-Lambert, *supra* note 10, at \*1.

<sup>120</sup> Holly J. Gregory et al., *United States, in GETTING THE DEAL THROUGH: CORPORATE GOVERNANCE 2015* 236, 246 (Holly J. Gregory ed., 2015).

<sup>121</sup> 958 F.2d 416, 427 (D.C. Cir. 1992).

<sup>122</sup> *Id.*

<sup>123</sup> LISA A. FONTENOT ET AL., *PRACTICAL GUIDE TO SEC PROXY AND COMPENSATION RULES* § 12.06 (5th ed. Supp. 2017).

*why* the fundamental business strategy carve-out was not applied, and thus the letters have limited value in determining what constitutes a fundamental business strategy. For example, in 2007, the SEC granted no-action relief to Western Union for a proposal related to prices charged on the company's products.<sup>124</sup> The Staff did not cite its reasoning. However, its decision does comport with Western Union's argument that it is distinguishable from the Eli Lilly line of decisions because Western Union's product pricing was not of national importance, while "Eli Lilly and Warner-Lambert each dealt with the issue of the affordability of prescription drugs, which has been and continues to be an issue of great national interest, debate, and importance."<sup>125</sup> Thus, it appears that the industry distinction rests on a perception of the national controversy surrounding pharmaceutical pricing issues.

A no-action letter issued to an insurance company may further demonstrate the Staff's intent to limit the application of the fundamental business strategy carve-out doctrine. In 2011, the SEC permitted UnitedHealth Group to exclude a proposal because the proposal related "to UnitedHealth's ordinary business operations . . . to the manner in which the company manages its expenses."<sup>126</sup> In that instance, the proposal sought information from the insurance company on "how our company is responding to regulatory, legislative and public pressures to ensure affordable health care coverage and the measures our company is taking to contain the price increases of health insurance premiums."<sup>127</sup> This is similar to the text of shareholder proposals at pharmaceutical companies—for which the Staff denied no-

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<sup>124</sup> The Western Union Co., SEC No-Action Letter, 2007 WL 754969, at \*1 (Mar. 7, 2007).

<sup>125</sup> *Id.* at \*4.

<sup>126</sup> UnitedHealth Group, *supra* note 88, at \*2.

<sup>127</sup> *Id.* at \*26.

action relief.<sup>128</sup> The Staff's refusal to allow shareholders of a health insurance company to utilize a similar form of proposal may indicate an intent to contain the fundamental business strategy carve-out not just within the healthcare industry, but also specifically to the pharmaceutical companies producing and pricing the drugs at issue.

Yet, the carve-out is not universally applied to all pricing proposals at pharmaceutical companies either. The Staff granted no-action relief to Johnson & Johnson, permitting the company to omit a shareholder proposal that asked the board to "review pricing and marketing policies and prepare a report on how our company will respond to rising regulatory, legislative, and public pressure to increase access to and affordability of needed prescription drugs."<sup>129</sup> In asking the SEC to allow omission, the company argued that, while pharmaceutical pricing on its own may not be excludable, "marketing policies" are clearly within the scope of the ordinary business exclusion.<sup>130</sup> The Staff appears to have agreed, finding "some basis" for the view that the company could "exclude the proposal under Rule 14a-8(i)(7), as relating to its ordinary business operations (i.e., marketing and public relations)."<sup>131</sup> The Johnson & Johnson letter may indicate how intentionally and specifically the SEC has targeted pharmaceutical *pricing*, rather than long-term policies within pharmaceutical companies, despite the reference to long-term policies in *Roosevelt*.<sup>132</sup>

To further complicate application of the fundamental business strategy carve-out, one letter demonstrates application of the carve-out to a shareholder proposal that is

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<sup>128</sup> Gilead Sciences, *supra* note 45, at \*2; Celgene Corp., SEC No-Action Letter, *supra* note 48, at \*1; Eli Lilly, *supra* note 10, at \*1; Warner-Lambert, *supra* note 10, at \*3.

<sup>129</sup> Johnson & Johnson, SEC No-Action Letter, 2004 WL 103227, at \*2, \*13 (Jan. 12, 2004).

<sup>130</sup> *Id.* at \*9.

<sup>131</sup> *Id.* at \*2.

<sup>132</sup> *Roosevelt v. E.I. DuPont de Nemours & Co.*, 958 F.2d 416, 427 (D.C. Cir. 1992).

both outside of the pharmaceutical industry and unrelated to pricing strategy. In 2002, the Staff refused to allow omission of a Pacific Gas & Electric (“PG&E”) shareholder proposal, stating that “the proposal, which relates to the Board of Directors’ participation in the development of fundamental business strategy and long-term plans, involves issues that are beyond matters of PG&E’s ordinary business operations.”<sup>133</sup> This proposal was unrelated to pricing and instead asked for additional disclosure of the company’s long-term strategic plans, including its “corporate strategy development process,” “timelines,” “compliance monitoring processes,” and “mechanisms in place to ensure director access to pertinent information.”<sup>134</sup>

The 2015 proxy season saw a “relatively new topic” of shareholder proposals “targeting how pharmaceutical companies determine the price of their products”<sup>135</sup> in which shareholders “asked boards to report on the risks from rising pressure to contain U.S. specialty drug prices.”<sup>136</sup> During that time, companies sought to omit the proposals by seeking a no-action letter from SEC Staff under the argument that such proposals should still fall under the ordinary business exception in Rule 14a-8(i)(7) because “setting the prices for products is a decision for management, not shareholders” and such proposals seek “to micro-manage the companies” and were related to significant policy issues only tangentially.<sup>137</sup>

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<sup>133</sup> PG&E Corp., SEC No-Action Letter, 2002 WL 253886, at \*2 (Jan. 24, 2002).

<sup>134</sup> *Id.* at \*3.

<sup>135</sup> Keir Gumbs, *Shareholder Proposals: Predicting the 2016 Proxy Season*, LEXIS NEXIS: LEXIS PRACTICE ADVISOR JOURNAL (Mar. 11, 2016), <https://www.lexisnexis.com/lexis-practice-advisor/the-journal/b/lpa/archive/2016/03/11/shareholder-proposals-predicting-the-2016-proxy-season.aspx> [perma.cc/Z73Y-FFUK].

<sup>136</sup> *Id.*

<sup>137</sup> GIBSON, DUNN & CRUTCHER LLP, SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2015 PROXY SEASON 14 (2015), <http://www.gibsondunn.com/publications/documents/Shareholder->

In response, the SEC has continued to apply the fundamental business strategy carve-out within the pharmaceutical industry, finding, in line with the decisions in the early 1990s, that the proposals focused on “fundamental business strategy with respect to its pricing policies for pharmaceutical products.”<sup>138</sup> For example, in response to Gilead’s request for a no-action letter, the SEC stated “the proposal focuses on Gilead’s *fundamental business strategy* with respect to its pricing policies for pharmaceutical products and does not seek to micromanage the company to such a degree that exclusion of the proposal would be appropriate.”<sup>139</sup> This is in line with the Commission’s goal to refuse omissions of proposals involving ordinary business decisions that “focus[] on sufficiently significant policy issues.”<sup>140</sup>

## ii. Issues with Resubmission

Particularly within the realm of pharmaceutical pricing proposals, which have historically received a low percentage of votes,<sup>141</sup> the resubmission exclusion means that the stakes are high for each shareholder proposal. One shareholder’s failure to garner sufficient support could rob all shareholders of their chance to put forth similar proposals for the following five years, so any proposal that is voted on must be successful enough to avoid sacrificing future proposals.<sup>142</sup> For example, in 2004 the SEC supported Bristol-Myers Squibb on these grounds, allowing the company to omit two

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Proposal-Developments-During-the-2015-Proxy-Season.pdf  
[<https://perma.cc/32LJ-3CTF>].

<sup>138</sup> *Id.*

<sup>139</sup> Gilead Sciences, *supra* note 45, at \*2 (emphasis added).

<sup>140</sup> *See* Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40018, Investment Company Act Release No. 23200, 67 SEC Docket 373 (May 21, 1998).

<sup>141</sup> *See infra* Section III.A.2.

<sup>142</sup> *See* 17 C.F.R. § 240.14a-8(i)(12) (2017); *see also infra* Section III.B.1.ii.

proposals.<sup>143</sup> One proposal, put forth by a pension plan provider, asked the board to “develop a policy of price restraint on prescription pharmaceutical products.”<sup>144</sup> Another, put forth by the Interfaith Center on Corporate Responsibility (“ICCR”), called for the board to review pricing policies and report on how the company “will respond to rising regulatory, legislative and public pressure to increase access to and affordability of needed prescription drugs.”<sup>145</sup> Bristol-Myers Squibb argued that the pension and ICCR proposals dealt with substantially the same subject matter as three other proposals voted on within the prior four years. Two had requested that the board create and implement a policy of price restraint “to keep drug prices at reasonable levels” and report to shareholders on changes in pricing policies.<sup>146</sup> The third had asked the board to report to shareholders on the creation and implementation of a policy of price restraints on prescription drugs “to keep drug prices at reasonable levels.”<sup>147</sup> The latter proposal was the most recently voted on, and it failed to receive the threshold of 10% votes required for resubmission of a fourth, similar proposal within the allotted timeframe.<sup>148</sup> As a result, the SEC granted no-action letter relief to Bristol-Myers Squibb and the proposals were omitted.<sup>149</sup>

The proposals excluded in Bristol-Myers Squibb were not identical to the proposals that served as the grounds for their exclusion under the resubmission rule.<sup>150</sup> In particular, the

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<sup>143</sup> Bristol-Myers Squibb Co., SEC No-Action Letter, 2004 WL 299070, at \*3 (Feb. 11, 2004).

<sup>144</sup> *Id.* at \*5.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at \*1.

<sup>147</sup> *Id.* at \*7.

<sup>148</sup> *Id.* at \*5. The most recent 2002 proposal received 3.5% of the votes, falling under Rule 14a-8(i)(12)(iii), which requires that the proposal receive 10% of votes cast in order for a similar proposal to be introduced within three subsequent years. *See id.*

<sup>149</sup> *Id.* at \*1.

<sup>150</sup> *Id.*

proposal by ICCR diverged from the previous proposals (which sought policies of price restraint and follow-up reporting on such changes) in asking for a report on the company's response to regulatory and legislative pressure related to drug access and affordability issues.<sup>151</sup> It appears that the similar nature of the proposals—a focus on the company's pricing policies—was sufficient to justify exclusion. This further underscores the importance of meeting threshold voting levels, as a failure to do so may impact all shareholder proposals of a similar sentiment even if future proposals include new components or ask for something different.

### iii. Company Opposition and Substantial Implementation

Companies often argue that product pricing is a daily function of management, thus falling under the ordinary business exclusion.<sup>152</sup> With regard to proposals calling for fair pricing analyses and reporting, some companies argue that such information is already contained in their disclosure materials and thus the proposals have already been substantially implemented. For example, with regard to a proposal seeking reports on the effect of unfair pricing on the company, Celgene pointed to disclosures in its 10-Q regarding “material risks created by competition, regulation and limits on reimbursements for its products” in order to argue that the proposal had already been substantially implemented.<sup>153</sup>

Asking the SEC for a no-action letter is inherently risky for companies, as they face mandatory inclusion in their proxy statements if the Staff does not agree with their interpretation and shareholders successfully sue to enjoin

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<sup>151</sup> *Id.* at \*2, 5.

<sup>152</sup> See Gilead Sciences, *supra* note 45, at \*17; Vertex Pharmacy, *supra* note 109, at \*14–15; Celgene Corp., SEC No-Action Letter, *supra* note 48, at \*12.

<sup>153</sup> Celgene Corp., SEC No-Action Letter, *supra* note 48, at \*5.

the company from excluding it. As a result, some companies try to extinguish shareholder proposals before the annual meeting through negotiations with the shareholder sponsoring the proposal.<sup>154</sup> Such negotiations can result in agreed-upon implementation of some aspects of the proposal, leading the shareholder to withdraw the proposal before any votes are cast.<sup>155</sup>

Where negotiations are ineffective or not attempted, many pharmaceutical companies circulate proxy voting policies instructing shareholders to vote against pharmaceutical price restraint on the contention that such pricing is integral to their company and should not be dictated by shareholders.<sup>156</sup> In the past, proxy guidelines buttressed these contentions. Recently, however, many proxy guidelines have indicated a willingness to compromise by advocating votes in favor of, or a case-by-case evaluation of, price reporting and disclosure, so long as it does not pose competitive or investment related risks.<sup>157</sup>

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<sup>154</sup> See *supra* Section II.C.3.

<sup>155</sup> See *infra* Section III.A.3.

<sup>156</sup> See GLASS LEWIS, PROXY PAPER GUIDELINES: 2016 PROXY SEASON 19 (2016), [http://www.glasslewis.com/wp-content/uploads/2016/01/2016\\_Guidelines\\_SHAREHOLDER-INITIATIVES-1.pdf](http://www.glasslewis.com/wp-content/uploads/2016/01/2016_Guidelines_SHAREHOLDER-INITIATIVES-1.pdf) [<https://perma.cc/K4P2G6UR>]; INST'L S'HOLDER SERVS., UNITED STATES SUMMARY PROXY VOTING GUIDELINES: 2015 BENCHMARK POLICY RECOMMENDATIONS 55 (2014), <https://www.issgovernance.com/file/policy/2015ussummaryvotingguidelines.pdf> [<https://perma.cc/CG5D-CTDC>]; DEUTSCHE BANK AG, PROXY VOTING POLICY AND GUIDELINES 27, [https://www.db.com/cr/img/Proxy\\_Voting\\_Policy\\_and\\_Guidelines\\_11.pdf](https://www.db.com/cr/img/Proxy_Voting_Policy_and_Guidelines_11.pdf) [<https://perma.cc/H5BM-7MBX>].

<sup>157</sup> *Id.*; AB GLOBAL, PROXY VOTING POLICY 17 (2015), [https://www.abglobal.com/abcom/our\\_firm/content/cgdocs/ab\\_proxy\\_voting\\_policy.pdf](https://www.abglobal.com/abcom/our_firm/content/cgdocs/ab_proxy_voting_policy.pdf) [<https://perma.cc/U9DC-4H35>]; see also *infra* Section III.B.2.

## 2. Proposal Voting Results and Accompanying Correlations

Recent shareholder proposals that sought reporting on the risks of high pricing of specialty drugs did not pass.<sup>158</sup> Table 1 shows the voting results on three such proposals from the 2015 proxy season:

TABLE 1. VOTING RESULTS REGARDING 2015  
SHAREHOLDER PROPOSALS RELATED TO PRICING OF  
PHARMACEUTICAL PRODUCTS

	Gilead <sup>159</sup>	Vertex <sup>160</sup>	Celgene <sup>161</sup>
Votes For	208,355,366	6,283,460	31,210,063
Votes Against	676,700,065	179,710,139	480,827,972
Abstentions	230,987,125	30,663,973	74,372,497
Broker Non-Voters	160,034,367	6,077,182	112,211,797
% Votes Cast "For"	23.5%	3.4%	6.1%

The Gilead Sciences proposal, while not garnering a majority of votes, received a significantly higher percentage of "for" votes than did the Vertex and Celgene proposals, with 23.5% of all votes cast being in favor of the Gilead proposal, as opposed to 3.4% and 6.1% for Vertex and Celgene, respectively.<sup>162</sup> Events leading up to Gilead's annual meeting showed that high involvement by the proponent shareholder correlated with a more successful vote. The proponent of Gilead's shareholder proposal, UAW, sent a series of letters to shareholders leading up to the

<sup>158</sup> Gilead Sciences, Inc., Quarterly Report (Form 8-K) (May 6, 2015); Vertex Pharmacy, Inc., Quarterly Report (Form 8-K) (June 4, 2015); Celgene Corp., Quarterly Report (Form 8-K) (June 18, 2015).

<sup>159</sup> Gilead Sciences, Quarterly Report, *supra* note 158.

<sup>160</sup> Vertex Pharmacy, Quarterly Report, *supra* note 158.

<sup>161</sup> Celgene Corp., Quarterly Report, *supra* note 158.

<sup>162</sup> *See supra* Table 1.

annual meeting.<sup>163</sup> On April 16, three weeks before the annual meeting, UAW sent a letter to shareholders outlining the need for increased transparency around Gilead's drug prices.<sup>164</sup> UAW contended that Gilead's stock price had fallen by 17% after a large pharmacy benefit manager announced that it would no longer cover some of Gilead's high-priced products, and that increased transparency of drug pricing strategies and attendant risks would allow investors to understand "if and how the board fully considered the risks" of their drug pricing.<sup>165</sup> On April 28, one week before the annual meeting, UAW notified shareholders that Institutional Shareholder Services ("ISS"), an influential proxy advisory firm, was supporting the shareholder proposal.<sup>166</sup> The letter also stated that the U.S. Senate Finance Committee "launched an investigation into Gilead's pricing of Sovaldi" and that such controversy had already impacted Gilead's performance through a loss in stock price.<sup>167</sup> The following day, UAW followed up with another letter that outlined the rationale behind the proposal and addressed potential shareholder questions.<sup>168</sup>

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<sup>163</sup> See Gilead Sciences, Inc. (Form PX14A6G) (Apr. 16, 2015); Gilead Sciences, Inc. (Form PX14A6G) (Apr. 28, 2015).

<sup>164</sup> Gilead Sciences (Apr. 16, 2015), *supra* note 163.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.* (informing shareholders that ISS was endorsing the shareholder proposal and added that, in support, ISS stated that the high costs of the drug, the disparity between the amount that Gilead charges in the United States versus in developing countries, and the high prevalence of individuals in the United States that are infected with HCV, many of whom rely on government benefits, has drawn a substantial volume of adverse media attention, two U.S. Senate investigations, and on-going class action litigation against the company); see also *infra* Section III.B.2 (addressing the role and importance of proxy advisory firms such as ISS).

<sup>167</sup> Gilead Sciences (Apr. 28, 2015), *supra* note 163 (alleging that regulators were investigating Gilead's pricing on a number of its products and noting that such controversy had already affected Gilead's stock price by 17%).

<sup>168</sup> See Gilead Sciences, Inc. (Form PX14A6G) (Apr. 29, 2015) (addressing the purpose of the proposal and noting that the proposal

The Celgene and Vertex proposals, in contrast, do not demonstrate significant activity on the part of the shareholder putting forth the proposal. In both cases, UAW came in at a later stage and “sponsored” the proposals, in each instance submitting a letter to the shareholders announcing its sponsorship.<sup>169</sup> However, UAW was not the proponent in either case, did not obtain ISS support, and did not provide multiple letters.<sup>170</sup>

### 3. Positive Impacts of Unsuccessful Proposals

As evidenced above, price-restraint proposals are an uphill battle for proponents.<sup>171</sup> Yet, shareholders pursuing such initiatives can use proposals to send a message to management and create pressure surrounding price hikes.<sup>172</sup>

Instead of pursuing a no-action letter from the SEC, management can choose to negotiate with the proponent shareholder to convince the shareholder to withdraw his or her proposal in light of changes that the company agrees to make.<sup>173</sup> This will often occur when “the management team wants to avoid negative publicity or an adverse vote result at the [annual meeting],”<sup>174</sup> and because of the impending meeting, a proposal “can fast-track dialogue for the simple

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would not require Gilead to reveal confidential or proprietary information).

<sup>169</sup> Vertex Pharmacy, Inc. (Form PX14A6G) (May 15, 2015); Celgene Corp. (Form Px14A6G) (June 1, 2015).

<sup>170</sup> *Id.*

<sup>171</sup> *See supra* Section III.A.2.

<sup>172</sup> *See* Peter Loftus, *Pfizer Share News*, ADVFN, <http://www.advfn.com/nyse/StockNews.asp?stocknews=PFE&article=47114100> [<https://perma.cc/6SES-VQXK>] (last visited June 3, 2017).

<sup>173</sup> Giovanna Michelon & Michelle Rodrigue, *Demand for CSR: Insights from Shareholder Proposals*, 35 SOC. & ENVTL. ACCOUNTABILITY J. 157, 159 (2015).

<sup>174</sup> DB Advisors, *Corporate Engagement by Institutional Shareholders*, DEUTSCHE BANK GROUP 4 (2013) [https://www.db.com/cr/en/docs/DB\\_Climate\\_Change\\_Advisors\\_-\\_Corporate\\_Engagement\\_Studie\\_\(en\).pdf](https://www.db.com/cr/en/docs/DB_Climate_Change_Advisors_-_Corporate_Engagement_Studie_(en).pdf) [<https://perma.cc/Y37J-XMAJ>].

reason that the clock is set for directors to respond with specificity prior to [the] meeting.”<sup>175</sup> Because management is negotiating from a defensive standpoint, “most activist shareholders consider managers to be the most responsive to proposals when they negotiate a withdrawal, rather than allowing a vote.”<sup>176</sup> As a result, the “ultimate value” of a shareholder proposal may not lie in its “short-term voting results,” but in its long-term ability to “bring about changes in corporations through dialogue, a reassessment of their challenged activities and/or industry spillover effects.”<sup>177</sup> Withdrawn proposals, which represent approximately 20% of all shareholder proposals each year, reflect “success for shareholders because their request has been partially or fully implemented.”<sup>178</sup>

Similarly, if the company wishes to exclude the proposal but is not comfortable relying on withdrawal, the substantial implementation exclusion allows companies to take small steps to partially implement proposals in order to avoid mandatory inclusion in their proxy materials. For example, UAW submitted shareholder proposals to six pharmaceutical companies requesting that the companies prepare reports on and explanations for “specialty drugs” costing more than \$600 per month.<sup>179</sup> Of those six proposals, three companies implemented “at least some aspects of the proposals”<sup>180</sup> in order to fall under this exclusion.

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<sup>175</sup> Gianna McCarthy & Eric Shostal, *Shareholder Resolutions and Constructive Dialogue*, in 21ST CENTURY ENGAGEMENT: INVESTOR STRATEGIES FOR INCORPORATING ESG CONSIDERATIONS INTO CORPORATE INTERACTIONS 16 (2015), <https://www.blackrock.com/corporate/en-hu/literature/publication/blk-ceres-engagementguide2015.pdf> [<https://perma.cc/65YK-DJRF>].

<sup>176</sup> Michelon & Rodrigue, *supra* note 173, at 160.

<sup>177</sup> *Id.*

<sup>178</sup> DB Advisors, *supra* note 174, at 4.

<sup>179</sup> See Ising, *supra* note 137.

<sup>180</sup> *Id.*

## B. The Role of Institutions

### 1. Institutional Investors' Growth in Power and Responsibility

As more American families have tapped into capital markets through pooled-investment vehicles, the role and influence of institutional investors has grown.<sup>181</sup> In fact, the SEC Commissioner has now framed institutional investors as “dominant market players”<sup>182</sup> who help “improve price discovery, increase allocative efficiency, and promote management accountability.”<sup>183</sup> Much of this power stems from the fact that institutional investors often control large pools of assets that belong to others, which they can wield as a cohesive voting unit.<sup>184</sup>

Being able to marshal large voting blocs makes institutional investors important to the outcome of proposals that are voted on at annual meetings. The pressure exerted by shareholder proposals that make it to the voting stage may be stronger where institutional investors are active proponents. For example, though Gilead defeated the 2015 proposal (asking for annual reports on the risks of its pricing policy),<sup>185</sup> the company voluntarily adopted a similar

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<sup>181</sup> Luis A. Aguilar, Comm’r, Sec. and Exch. Comm’n, Institutional Investors: Power and Responsibility (Apr. 19, 2013) (transcript available at <https://www.sec.gov/News/Speech/Detail/Speech/1365171515808> [<https://perma.cc/N8Z4-NK6Q>]).

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> Specifically, the resolutions sought information regarding “drug development costs; relationships between pricing, clinical benefits and patient access; price disparities between the U.S. and other countries; price sensitivity of payers and patients; and whether payers are increasingly likely to use cost-effectiveness techniques to make reimbursement decisions.” Ed Silverman, *Gilead and Vertex Shareholders Can Vote on Pricing Resolutions: SEC*, WALL. ST. J.: PHARMALOT (Mar. 12, 2015, 11:09 AM), <http://blogs.wsj.com/pharmalot/2015/03/12/gilead-and-vertex-shareholders-can-vote-on-pricing-resolutions-sec> [<https://perma.cc/9XH9-RK7N>].

reporting procedure the following year.<sup>186</sup> The fact that 23.5% of votes cast were “for” the proposal may have pressured the company to implement similar policies, and the active involvement of a large institutional shareholder (UAW) probably helped achieve that voting result.<sup>187</sup>

Where institutional investors own large percentages of a firm’s outstanding shares, they may “threaten to sell” their stake if the company does not implement policies that received significant, if not majority, support.<sup>188</sup> The sale of a sufficiently large ownership stake would adversely impact the company’s stock price and, therefore, could adversely affect executive compensation through stock options.<sup>189</sup> Thus, the involvement of a large institutional investor can put pressure on directors and officers in a way that individual shareholders holding smaller stakes often cannot.

Similarly, institutional investors can exert significant pressure on companies during the negotiation phase, between the filing of a shareholder proposal and the annual meeting. If withdrawal is considered a sign of shareholder success,<sup>190</sup> then the frequency of withdrawal sheds some light on how successful proponent shareholders are during negotiations. One study shows that proposal sponsorship by institutional investors is positively correlated with a proposal’s withdrawal likelihood, finding that 42.4% of Corporate Social Responsibility proposals filed by institutional investors and 33% of those filed by unions were withdrawn,<sup>191</sup> while only 4.4% of those filed by individual investors were withdrawn.<sup>192</sup> The disparity in withdrawal

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<sup>186</sup> See Barkholz, *supra* note 43.

<sup>187</sup> See *supra* Section III.A.2.

<sup>188</sup> DB Advisors, *supra* note 174, at 4.

<sup>189</sup> *Id.* at 22.

<sup>190</sup> “The most powerful proposal type: Withdrawn shareholder proposals.” *Id.*

<sup>191</sup> Rob Bauer et al., *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 CORP. GOV.: AN INT’L REV. 472, 478 (2015).

<sup>192</sup> *Id.*

percentage demonstrates that individual investors are less able to negotiate change with the company than are institutional investors, either because the individuals are ineffective during negotiations or because they are unable to get a seat at the bargaining table in the first place.

In addition to institutional investors often having large ownership stakes, they also tend to wield power through their ability to communicate their agenda outside of the private negotiation setting. This involves making their proposal's subject and supporting evidence known by a wider audience, including circulating materials to other shareholders and communicating with the media.<sup>193</sup> However, this additional step of circulating materials involves an extra cost to the proposal sponsor<sup>194</sup>—including legal fees, proxy solicitation fees, and advertising and public relations expenses<sup>195</sup>—which may be another reason that institutional investors, rather than individuals, are better positioned to successfully leverage proposals.

## 2. The Importance of Proxy Advisory Firms

Another set of “important players” are proxy advisory firms, which counsel shareholders on how to vote their shares on issues of corporate governance and corporate responsibility at annual meetings.<sup>196</sup> SEC commissioner Michael Piwowar stated that proxy advisory firms exercised

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<sup>193</sup> DB Advisors, *supra* note 174, at 5.

<sup>194</sup> ALLEN & KRAAKMAN, *supra* note 61, at 208. One of the benefits of Rule 14a-8 from a shareholder perspective is low cost, as the company will circulate proxy materials to shareholders with the proposal included. Thus, the fact that additional money may need to be spent to circulate additional materials in order to increase probability of success may undermine one of the goals of the rule.

<sup>195</sup> Michael Levin, *Exempt Proxy Solicitations*, ACTIVIST INVESTOR, [http://www.theactivistinvestor.com/The\\_Activist\\_Investor/Exempt\\_Solicitations.html](http://www.theactivistinvestor.com/The_Activist_Investor/Exempt_Solicitations.html) [<https://perma.cc/5DEL-FT5S>] (last visited June 3, 2017).

<sup>196</sup> Nadya Malenko & Yao Shen, *The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design*, 29 REV. FIN. STUDIES 3394, 3395 (2016).

“outsized influence on shareholder voting.”<sup>197</sup> Yet it should be noted that some debate remains as to the importance of proxy advisory firm policies and whether their recommendations cause voting changes or simply correlate with certain voting outcomes.<sup>198</sup>

The two most prominent proxy advisory firms are ISS and Glass Lewis.<sup>199</sup> One study finds that there is a strong correlation between ISS’s recommendations and voting outcomes.<sup>200</sup> In the past, both firms encouraged shareholders to vote against proposals calling for any kind of price restraint or price reporting; however, ISS and Glass Lewis have since transitioned to a “case-by-case” evaluation of proposals asking for product pricing or medicine access reports and a recommendation to “vote for” reports on the financial and legal impacts of drug policies.<sup>201</sup> In 2016, ISS updated its proxy guidelines again, making two changes to its factors of consideration for determining voting advice on pharmaceutical pricing proposals.<sup>202</sup> First, ISS added

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<sup>197</sup> Michael S. Piwowar, Address at the 2013 SEC Proxy Advisory Firms Roundtable (Dec. 5, 2013), <https://www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt> [<https://perma.cc/6FRV-4TMR>].

<sup>198</sup> See Malenko & Shen, *supra* note 196, at 3395–96.

<sup>199</sup> Andrey Malenko & Nadya Malenko, Proxy Advisory Firms: The Economics of Selling Information to Voters 5 (unpublished manuscript) (Jan. 31, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2757597](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2757597). ISS controls 61% of the market and Glass Lewis controls 36% of the market, with other proxy advisory firms having a much smaller market share. *See id.*

<sup>200</sup> *Id.* at 2.

<sup>201</sup> INSTITUTIONAL SHAREHOLDER SERVICES, UNITED STATES SUMMARY PROXY VOTING GUIDELINES: 2016 BENCHMARK POLICY RECOMMENDATIONS 58–59 (2015), <https://www.issgovernance.com/file/policy/2016-us-summary-voting-guidelines-dec-2015.pdf> [<https://perma.cc/W5MW-U877>]. As of this release, ISS still recommended voting against proposals asking companies to implement specific price restraints *unless* the company was failing to adhere to legislative guidelines or industry norms in its practices. *See id.*

<sup>202</sup> Trevor G. Pinkerton, *2016 Proxy Guidelines Update from ISS and Glass Lewis*, NORTON ROSE FULBRIGHT (2015), <http://www.nortonrosefulbright.com/knowledge/publications/134883/2016->

“regulatory risk” to its description of risk exposure (where previously only reputational and market risk were considered).<sup>203</sup> Second, ISS called for disclosure of policies related to “recent significant controversies, litigation, or fines at the company.”<sup>204</sup> These modifications are “meant to reflect the increased criticism regarding the pricing of pharmaceutical products, especially in regards to specialty drugs.”<sup>205</sup> With regard to proposals that go beyond reporting and ask for policy changes, ISS recommends voting against—*unless* the company is failing to adhere to “legislative guidelines or industry norms in its product pricing practices.”<sup>206</sup> This clause demonstrates that ISS considers how a company’s product pricing compares to others in the industry. Glass Lewis’ policy, while still advocating a case-by-case evaluation, says the firm will “consider supporting proposals in cases where proponents have clearly demonstrated that a company’s current practices or policies present significant financial or reputational harm.”<sup>207</sup> These shifts demonstrate an openness on the part of proxy advisory firms to advocate for shareholder proposals that seek pricing restraint and impact reporting, which has the potential to cause—or correlate with—an uptick in “for” votes and may increase proponent bargaining positions as a result.

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proxy-guidelines-update-from-iss-and-glass-lewis [https://perma.cc/3RQ5-EBQU].

<sup>203</sup> INSTITUTIONAL SHAREHOLDER SERVICES, *supra* note 201, at 58.

<sup>204</sup> *Id.* at 59.

<sup>205</sup> *Id.*

<sup>206</sup> *Id.* at 58.

<sup>207</sup> Pinkerton, *supra* note 202; GLASS LEWIS, 2017 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE, SHAREHOLDER INITIATIVES 20 (2016), [http://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines\\_Shareholder\\_Initiatives.pdf](http://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_Shareholder_Initiatives.pdf) [https://perma.cc/LYD8-KXT9].

#### IV. RECOMMENDATIONS

##### A. The SEC Should Continue to Include Pharmaceutical Pricing Proposals

The SEC should not modify its approach to evaluating pharmaceutical pricing proposals and price impact report proposals. When evaluating proposals asking for reports, the Staff will evaluate the underlying subject of the report. For example, it will “consider whether the subject matter of the [requested] report or [study] committee involves a matter of ordinary business: where it does, the proposal [is] excludable under Rule 14a–8(c)(7).”<sup>208</sup> Given the Staff’s history of finding pricing of pharmaceutical drugs to fall outside of the ordinary business exclusion due to social policy issues, shareholder proposals that ask pharmaceutical companies to evaluate the effect of their pricing strategies on long-term product prospects should continue to pass no-action letter scrutiny, so long as they do not incorporate other reporting or policy requirements within the same proposal.

Whether proposals directly asking companies to implement policies of price restraint will continue to be included in proxy materials is somewhat less clear. Since the Warner-Lambert and Eli Lilly shareholder proposals in 1993, the SEC’s stance has not been tested by a second wave of proposals directly asking companies to implement a new pricing strategy. The closest is a proposal to Bristol-Myers Squibb in 2000, asking the board to “[c]reate and implement a policy of price restraint on pharmaceutical products . . . utilizing a combination of approaches to keep drug prices at reasonable levels . . . [and r]eport to shareholders . . . on changes in policies and pricing procedures.”<sup>209</sup> In that

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<sup>208</sup> Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20091, 48 Fed. Reg. 38,218, 38,221 (Aug. 23, 1983) (codified at 17 C.F.R. pt. 240); *see also* *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 428 (D.C. Cir. 1992).

<sup>209</sup> *Bristol-Myers Squibb*, *supra* note 105, at \*3.

instance, the SEC refused to grant no-action relief to the company, finding that the proposal “relates to Bristol-Myers’ fundamental business strategy, i.e., its pricing policy for pharmaceutical products.”<sup>210</sup> While the SEC is not legally bound by prior letters, it should continue to apply the fundamental business strategy carve-out in a way that is consistent with prior decisions.<sup>211</sup> Though untested in recent years, this should allow proposals for changes in pricing policy to survive companies’ exclusion attempts. While such proposals are not likely to obtain majority voting support at this time,<sup>212</sup> the pressure they create may bolster institutional investor arguments at the bargaining table between filing and the annual meeting.<sup>213</sup>

To improve likelihood of inclusion, sponsors should carefully tailor the text of their proposals. To take advantage of the fundamental business strategy carve-out under the ordinary business exclusion, a proposal’s scope should be limited to pricing policies (e.g., implementation of new pricing policies or reports about impacts of existing pricing policies).<sup>214</sup> Sponsors should avoid—or work with a cooperating shareholder to separately propose—diversions into other areas that may seem to be related, such as the marketing of high-priced products, in order to maximize the probability of inclusion.<sup>215</sup>

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<sup>210</sup> *Id.* at \*2.

<sup>211</sup> SEC no-action letters are not binding precedent for future decisions; *see supra* Section II.C.1.

<sup>212</sup> *See supra* Section III.A.2 (demonstrating that shareholder proposals related to pharmaceutical pricing often fail to receive a majority vote).

<sup>213</sup> *See supra* Section III.B.1 (noting that institutional investors may have strong bargaining power between filing and the annual meeting, when management of the firm often seeks to exclude the proposal by negotiating a withdrawal).

<sup>214</sup> *See supra* Section III.A.1.i.

<sup>215</sup> *Id.*

## B. Institutional Investors Must Take Action

As long as the SEC's stance on pharmaceutical pricing policies remains the same, shareholders have an opportunity to pressure pharmaceutical companies to implement more reasonable pricing policies. Shareholders should consider a proposal to be successful if it meets any of the following three criteria: first, if it garners sufficient support to obtain a majority vote at the annual meeting;<sup>216</sup> second, if it garners enough support at the annual meeting to send a strong signal to management and provide leverage for proponent shareholders to rely upon after the meeting, even if a majority was not obtained;<sup>217</sup> and third, if the proponent ultimately withdraws the proposal as the result of a satisfactory negotiation with the company, through which the proponent obtains at least some implementation of their essential objectives.<sup>218</sup> While the latter two measures of success do not result in a passing vote, they have been shown to be effective in causing a company to make policy changes.<sup>219</sup>

Yet, a successful proposal—regardless of whether success is measured by some threshold of votes-in-favor or negotiated proposal withdrawal—likely requires significant involvement by an institutional shareholder.<sup>220</sup> UAW's

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<sup>216</sup> See *supra* Section III.A.2

<sup>217</sup> See *supra* Section III.A.3 (showing the positive impacts post-meeting where the proposal had strong support, even though not from a majority); see also *supra* Section III.B.1 (indicating that institutional investors may rely on that support in pressuring the company to make changes after the annual meeting).

<sup>218</sup> See *supra* Section III.A.3 (discussing the perceived success where a proposal was withdrawn and the widespread practice of negotiating with institutional shareholders between filing of the proposal and the annual meeting).

<sup>219</sup> *Id.*

<sup>220</sup> See *supra* Section III.A.2 (demonstrating that active engagement by an institutional shareholder correlates with a stronger vote result); see also *supra* Section III.B.1 (institutional investors wield significant power to gather shareholder votes and negotiate with the board).

noticeably high vote with the Gilead proposal demonstrates this correlation.<sup>221</sup> In order to retain the SEC-created opportunity to pressure boards on their drug pricing strategies, proponent shareholders must ensure that their proposals obtain enough votes to protect future proposals from the resubmission ban.<sup>222</sup> This requires proponents to engage with other shareholders to demonstrate their reasoning, which is time-consuming and expensive.<sup>223</sup> Thus, sponsors of fair pricing proposals should remain active after filing and finance the wide distribution of supporting materials between the filing and the annual meeting. Only a limited number of individual shareholders who are active in using Rule 14a-8 could likely finance the costs of such widespread distribution. For example, Evelyn Davis and John Chevedden utilize this mechanism.<sup>224</sup> Yet, they may not carry the same reputational value that a large institution carries—in fact, in some instances, being so well known for putting forth shareholder proposals as an individual may hurt their ability to sway other shareholders. These individuals also may not have the same access to media. The parties best suited to step up to the shareholder proposal plate on pharmaceutical pricing are the institutional investors with money to spend on distribution of letters and supporting materials.

The pool of institutional shareholders whose interests align on such issues may grow as the financial industry begins to recognize the adverse effects that high-priced

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<sup>221</sup> See *supra* Section III.A.2.

<sup>222</sup> See *supra* Section II.C.4 (explaining how the resubmission ban functions); see also *supra* Section III.A.1.ii (identifying instances of the resubmission ban being used to bar pharmaceutical pricing proposals).

<sup>223</sup> See *supra* Section III.A.1.ii.

<sup>224</sup> See Richard Jerome, *Evelyn Y. Davis*, PEOPLE (May 20, 1996, 12:00 PM), <http://people.com/archive/evelyn-y-davis-vol-45-no-20> [<https://perma.cc/G4KK-N7YK>]; Steven Davidoff Solomon, *Grappling with the Cost of Corporate Gadflies*, N.Y. TIMES DEALBOOK (Aug. 19, 2014, 8:02 PM), <http://dealbook.nytimes.com/2014/08/19/grappling-with-the-cost-of-corporate-gadflies/?r=0> [<https://perma.cc/4R7J-QZXW>].

pharmaceuticals can have on the overall value of their investment.<sup>225</sup> This is underscored by the advice given by proxy advisory institutions, encouraging shareholders to conduct case-by-case evaluations of pricing restraint proposals rather than abiding by a blanket policy of voting against such proposals.<sup>226</sup>

While some individuals and institutional investors may be able to garner enough votes to keep future proposals from the resubmission graveyard, the ultimate goal is not to survive a resubmission ban. In order to force boards to consider changes to their drug pricing strategies or report on the impacts of those strategies, proponent shareholders would also be wise to engage directly with the board. On this front, institutional shareholders have dramatically more success than individuals.<sup>227</sup> Labor unions, pension funds, and other forms of large-scale investors are able to put the weight of their stock holdings behind the proposal, risking a stock slump that would impact the company's perceived value as well as the actual value of compensation for many members of the board. This puts institutional investors in a strong position to be heard.

### C. Proponents Should Utilize Historical Proposal Forms and Consider New Forms

As discussed above, shareholder proposals related to pharmaceutical pricing often take one of two forms.<sup>228</sup> Recently, shareholders have favored proposals for reporting on the impacts and risks of the company's pricing strategies, but historically, the SEC has also required inclusion of proposals for actual changes to pricing policies.<sup>229</sup> Yet, SEC rules only allow a shareholder to put forth one proposal per

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<sup>225</sup> See *supra* Section II.B.

<sup>226</sup> See *supra* Section III.B.2.

<sup>227</sup> See *supra* Section III.B.1 (showing the difference in negotiated withdrawals between institutional investors and individuals).

<sup>228</sup> See *supra* Section III.A.

<sup>229</sup> *Id.*

annual meeting.<sup>230</sup> Thus, when institutional investors decide to take action, they will have to choose whether to utilize one approach in particular, combine them, or create a new form.

Because proposals requesting actual price changes would demand more from the company than a report on pricing impacts, a proposal for actual change may present a stronger front and yield more bargaining power for its proponent. On the other hand, there are valid reasons why an investor should prefer a reporting proposal. First, while there is evidence that pharmaceutical price gouging can have a negative long-term impact on a company's stock price,<sup>231</sup> investors should hesitate to directly request price changes without confirmation that such a risk is present in their own investment. When the presence of such a risk is unconfirmed, institutional investors should begin by putting forth a reporting proposal, signaling to management that the shareholder is probing the impact of drug prices on the company's financial health, without committing to a public request for price changes. For a similar reason, if the shareholder intends for the proposal to be voted on at the annual meeting,<sup>232</sup> a reporting proposal may result in a stronger vote because it provides a gentler and more defensible on-ramp for shareholders whose votes the proponent seeks.

Yet, because the SEC has historically considered price change proposals to fall within the "fundamental business strategy" carve-out from the ordinary business exclusion,<sup>233</sup> institutional investors should also consider using that form of proposal. This is particularly true for institutional investors who have already concluded that the company's

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<sup>230</sup> 17 C.F.R. § 240.14a-8(c) (2017).

<sup>231</sup> *See supra* Section II.B.

<sup>232</sup> Many institutional investors wield strong power during the negotiation phase between filing the proposal and the annual meeting, and thus those intending to negotiate a withdrawal may have no intention of bringing their proposal to a vote at the annual meeting. *See supra* Section III.B.1.

<sup>233</sup> *See supra* Section III.A.1.i.

pricing policies are risky or depressing stock value—a conclusion which may or may not be the result of a previous year's reporting proposal. This approach should also be considered by an institution with significant bargaining power vis-à-vis the company—either because the investor holds a significant portion of the company's outstanding stock or because the investor represents a coalition of stockholders whose holdings represent such a portion in combination. A proposal that requests price changes may further buttress such a shareholder's bargaining power because support for such a proposal demonstrates a commitment not just to investigate the impact of pharmaceutical prices, but to change them.

In addition to reporting and price change proposals, shareholders should also consider methods for tying executive compensation to future setbacks the company may face on account of its product pricing. A group of thirteen institutional investors recently collaborated with BlackRock to “develop a set of internal executive compensation policies to ‘claw back’ pay in the event of fraudulent activities or misconduct.”<sup>234</sup> A similar formulation could be used to draft shareholder proposals for claw-back provisions, which could, for example, claw back compensation in the event that a pharmaceutical product is denied insurance coverage due to its price. Such a proposal should be strongly considered by shareholders of companies whose executives receive sizable, one-time bonuses upon federal approval of a drug or upon the drug beginning to make a profit. For example, in 2015, Vertex senior executives were set to reap more than \$53 million in one-time bonuses once the company's new cystic fibrosis drug began turning a profit.<sup>235</sup> If that bonus had been linked to insurance coverage through a claw-back

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<sup>234</sup> See McCarthy & Shostal, *supra* note 175, at 16.

<sup>235</sup> Robert Weisman, *Cystic Fibrosis Drug Could Bring Millions to Executives*, BOSTON GLOBE (May 1, 2015), <https://www.bostonglobe.com/business/2015/04/30/bonuses-granted-senior-vertex-executives-are-increasingly-rare-compensation-specialists-say/QWQnwztbou0TYAER9ykhnJ/story.html> [<https://perma.cc/DK9R-KCJ6>].

provision, a subsequent cost-related denial of coverage by any state's Medicaid program could have forced executives to return money to the company. Institutional investors should consider using shareholder proposals to push for implementation of such claw-back provisions in order to incentivize executive restraint in determining drug pricing policies. In a similar vein, proposals could request that executive stock options vest with a longer time-horizon so that executives making drug pricing decisions are forced to consider longer-term effects on their compensation packages and bear the risk that their pricing decisions may impact stock prices in the future. Focusing a shareholder proposal on executive compensation may remedy investor hesitation to ask for specific price changes while tying the pressure to contain pharmaceutical prices directly to the way senior executives are paid.

#### D. Individuals Wishing to Advocate Through Shareholder Proposals Should Focus Efforts on Pension Funds

While institutional investors are best situated to leverage shareholder proposals, their willingness to do so depends on the motivations of their decision-makers. Despite some evidence that surging prices have a negative long-term impact on the financial health of their pharmaceutical investment,<sup>236</sup> hesitant investors may still require a push in the right direction. Individuals who want these investors to take action should therefore consider using political pressure to encourage those entities.

Of institutional investors, pension plans may be most susceptible to this approach because many of their board members, such as appointed and ex-officio trustees, are exposed to political forces.<sup>237</sup> Appointed trustees are

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<sup>236</sup> See *supra* Section II.B.

<sup>237</sup> David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 196–97 (2005).

generally chosen by governors or legislatures, while ex-officio trustees serve on the board because of holding a particular public office, such as state controller.<sup>238</sup> Appointed trustees are exposed to outside political pressure from the person who appointed them, knowing they could be removed and replaced if desired.<sup>239</sup> Ex-officio trustees are directly exposed to political pressure from constituents and others in their party.<sup>240</sup>

Yet, even for plans with a high percentage of politically affiliated trustees, the fund's solvency will impact its willingness to advocate for lower pharmaceutical prices. A pension plan calculates its payment obligations in advance, and its Funding Ratio measures its ability to meet those obligations.<sup>241</sup> An under-funded plan will be forced to compete with other government projects for additional contributions from the state government. Therefore, under-funded pension plans have an incentive to increase their Funding Ratio by maximizing short-term profit.<sup>242</sup> As a result, pension plans with Funding Ratios at or above 100% are more likely to have enough of a financial buffer to take a long-term view and forego some short-term profits.

Thus, the most immediately appropriate advocates for pharmaceutical pricing proposals may be solvent pension plans with a high percentage of politically affiliated trustees. Table 2 measures some of the nation's largest pension plans on both of these criteria.<sup>243</sup> The plans are depicted vertically by level of political susceptibility, measured by the

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<sup>238</sup> *Id.* at 196.

<sup>239</sup> Governors and other parties who appoint trustees for pension fund boards may have the ability to remove their appointed trustees at any time. For example, "the Governor of California removed four appointed trustees from the California State Teachers' Retirement System's ("CalSTERS") board after they voted to oppose his proposal to reform the public pension fund." *Id.* at 197.

<sup>240</sup> *Id.*

<sup>241</sup> *Id.* at 192–93.

<sup>242</sup> *Id.* at 193.

<sup>243</sup> See *infra* Appendix A for the data behind Table 2.

percentage of each institution's board that holds a trusteeship ex-officio or as an appointed trustee.<sup>244</sup> The plans are also depicted horizontally based on the Funding Ratio of each institution.<sup>245</sup>

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<sup>244</sup> For political susceptibility, unless noted as an exception, see NAT'L ASS'N OF STATE RET. ADM'RS, COMPOSITION OF PUB. RET. SYS. BDS. (2016), <http://www.nasra.org/files/Topical%20Reports/Governance%20and%20Legislation/Board%20Governance%20Policies/Board%20Composition.pdf> [<https://perma.cc/8WJA-CZ23>] (appointed and ex-officio positions were combined and divided by the overall board size for each plan). For the Washington State Law Enforcement Officers and Fire Fighters' Plan 1 and 2, see WASH. REV. CODE § 41.26.715(1) (2007). For the Alaska Public Employees' Retirement System, see ALASKA STAT. 37.10.210(b). For the Maine Public Employees Retirement System, see ME. STAT. tit. 5, § 17102 (2016). For the Nebraska School Employees Retirement System, see NEB. REV. ST. § 79-904. For the New York State and Local Employees Retirement System and New York State and Local Police & Fire, see N.Y. STATE & LOCAL RETIREMENT SYSTEM, 2016 COMPREHENSIVE ANNUAL FINANCIAL REPORT (2016), [http://www.osc.state.ny.us/retire/about\\_us/annual\\_report\\_2016/index.php](http://www.osc.state.ny.us/retire/about_us/annual_report_2016/index.php) [<https://perma.cc/JL2U-WH84>]. For the North Carolina Local Governmental Employees' Retirement System and North Carolina Teachers and State Employees Retirement System, see NORTH CAROLINA DEPARTMENT OF STATE TREASURER, TSERS/LGERS-Board, <https://www.nctreasurer.com/ret/Pages/TSERS-and-LGERS-Board.aspx> [<https://perma.cc/8XYE-DS2U>] (last visited June 3, 2017).

<sup>245</sup> For Funding Ratios, unless noted as an exception, see REBECCA A. SIELMAN, 2016 PUBLIC PENSION FUNDING SURVEY, MILLIMAN (2016), <http://www.milliman.com/uploadedFiles/insight/Periodicals/ppfs/2016-public-pension-funding-study.pdf> [<https://perma.cc/6JHP-6J9D>]. For California Public Employees' Retirement System, see CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, 2015–16 COMPREHENSIVE ANNUAL FISCAL REPORT 4 (2016), <https://www.calpers.ca.gov/docs/forms-publications/cafr-2016.pdf> [<https://perma.cc/UP7H-XCSF>]. For the Funding Ratio for Nebraska School Employees Retirement System, see NEB. LEGISLATURE, 2016 SUMMARY AND DISPOSITION OF BILLS, 104th Leg. 2d Session, at 84, <http://nebraskalegislature.gov/pdf/reports/committee/retirement/sessionsummary2016.pdf> [<https://perma.cc/P5LG-H38X>] (last visited June 3, 2017).

TABLE 2. PENSION PLANS BY FUNDING RATIO AND POLITICAL SUSCEPTIBILITY<sup>246</sup>

		Funding Ratio of Plan		
		<95%	95%–100%	>100%
Political Susceptibility (Percentage of Appointed + <i>Ex Officio</i> Trustees)	>75%	OR-PERS, ID-PERS, NE-PERS, URS, IA-PERS, GA-TRS, AR-PERS, TX-TRS, IN-PERF, GA-ERS, NV-PERS, OK-TRS, AZ-SRS, MI-ERS, NHRS, AK-PERS, MI-PSERS, IN-TRF, PA-SERS, KS-PERS, MainePERS, CalSTRS	NY-SLPP, NC-LGERS, NYSLRS, OK-PERS	WA-LEOFF, WRS
	50%–75%	MO-SEP, NM-ERB, RI-ERS, PA-PSERS, CT-TRS, SFERS, NY-TRS, LACERA, SDCERS, MN-PERA, CalPERS, IL-TRS, IL-SERS, AL-ERS, TX-ERS	TCRS	NYSTRS
	25%–50%	NC-TSERS, VRS, KY-ERS, MO-PSRS, NC-TSERS, MN-SRS, MN-TRA, OH-PERS, OH-STRS, OH-OP&F, OH-SERS, CO-PERA, LASERS, NJ-PERS, AL-TRS, AR-TRS, TRSL		
	<25%	KY-TRS, MS-PERS, NM-PERA		SDRS

As depicted above, the majority of public pension funds analyzed are under-funded; however, a few stand out as being fully- or over-funded. WA-LEOFF (Washington State Law Enforcement Officers’ and Fire Fighters’ Plan 1 and 2, or the “Washington Pension”), NYSTRS (New York State Teachers’ Retirement System, or the “New York Pension”), SDRS (South Dakota Retirement System, or the “South Dakota Pension”), and WRS (Wisconsin Retirement System,

<sup>246</sup> See *infra* Appendix A for a list of pension plan acronyms used in Table 2.

or the “Wisconsin Pension”) have Funded Ratios of 116.9%, 110.5%, 104.1%, and 102.7%, respectively. Of these, the Washington, Wisconsin, and New York Pensions boards are most susceptible to political pressure, with 100% of the Washington Pension, 85% of the Wisconsin Pension, and 60% of the New York Pension being politically affiliated, while only 19% of the South Dakota Pension’s board is politically affiliated. A number of pension funds are within 5% of being fully funded and have boards comprised entirely of politically-affiliated trustees, including NY-SLPF (the New York State and Local Police & Fire), NC-LGERS (the North Carolina Local Governmental Employees’ Retirement System), NYSLRS (the New York State and Local Employees Retirement System), and OK-PERS (the Oklahoma Public Employees Retirement System). The aforementioned pension systems represent the institutions that are both exposed to political pressure and financially able to leverage an effective pharmaceutical pricing proposal.

## V. CONCLUSION

Surging pharmaceutical prices create health and financial problems for patients and insurance programs and pose a threat to the long-term financial stability of the pharmaceutical companies that develop and sell them. While shareholders of most companies cannot impact product pricing through Rule 14a-8, the SEC has carved a path through which shareholders of pharmaceutical companies can address these concerns. Yet, shareholders who take advantage of that opportunity have been historically unsuccessful. The typical vote in such situations is so low that each proposal threatens to temporarily remove the path altogether because of a resubmission ban. In order to ensure that shareholders have access to proxy materials for pharmaceutical pricing concerns, and to pressure companies to make real changes, institutional investors must wield their persuasive and economic power. Institutional investors should propose and actively support shareholder proposals that pressure boards of pharmaceutical companies to re-evaluate their pricing strategies in the context of patient

access, regulatory approvals, coverage decisions, and long-term share prices. Such action by institutional investors will bring the SEC-created carve-out to fruition and create lasting change in the pharmaceutical landscape.

## APPENDIX A

Plan Name	Abbreviation	Funded Ratio	Appointed Ratio	Board Size	Appointed, Ex Officio
Ala. Employees' Ret. Sys.	AL-ERS	66.1%	50%	14	7
Ala. Teachers' Ret. Sys.	AL-TRS	71.0%	29%	14	4
Alaska Pub. Employees' Ret. Sys.	AK-PERS	64.0%	100%	9	9
Ariz. State Ret. Sys.	AZ-SRS	68.4%	100%	9	9
Ark Pub. Emps. Ret. Sys.	AR-PERS	80.4%	100%	9	9
Ark. Teachers Ret. Sys.	AR-TRS	82.2%	27%	15	4
Cal. Pub. Emps. Ret. Sys.	CalPERS	69.0%	54%	13	7
Cal. State Teachers' Ret. Sys.	CalSTRS	74.0%	75%	12	9
Colo. Pub. Employees' Ret. Ass'n	CO-PERA	64.2%	33%	12	4
Conn. State Teachers' Ret. Sys.	CT-TRS	61.5%	58%	12	7
Ga. Employees' Ret. Sys.	GA-ERS	76.2%	100%	7	7
Ga. Teachers' Ret. Sys.	GA-TRS	81.4%	100%	10	10
Idaho Pub. Emp. Ret. Sys.	ID-PERS	91.4%	100%	5	5
Ill. State Employees' Ret. Sys.	IL-SERS	35.3%	54%	13	7
Ill. State Teachers' Ret. Sys.	IL-TRS	41.5%	54%	13	7
Ind. Pub. Employees' Ret. Fund	IN-PERF	77.3%	100%	6	6
Ind. State Teachers' Ret. Fund	IN-TRF	45.7%	100%	5	5
Iowa Pub. Employees' Ret. Sys.	IA-PERS	85.2%	100%	11	11
Kan. Pub. Emp. Ret. Sys.	KS-PERS	64.9%	78%	9	7
Ky. Employees' Ret. Sys.	KY-ERS	21.7%	44%	9	4
Ky. Teachers' Ret. Sys.	KY-TRS	42.5%	22%	9	2

Plan Name	Abbreviation	Funded Ratio	Appointed Ratio	Board Size	Appointed, Ex Officio
L.A. Cnty. Emps. Ret. Ass'n	LACERA	86.3%	56%	9	5
La. State Emps. Ret. Sys.	LASERS	62.7%	33%	9	3
La. Teachers' Ret. Sys.	TRSL	62.5%	25%	16	4
Me. Pub. Emps. Ret. Sys.	MainePERS	81.2%	75%	8	6
Mich. Pub. Sch. Emp.'s Ret. Sys.	MI-PSERS	62.9%	100%	12	12
Mich. State Emps. Ret. Sys.	MI-ERS	66.0%	100%	9	9
Minn. Pub. Emps. Ret. Ass'n	MN-PERA	78.2%	55%	11	6
Minn. State Ret. Sys.	MN-SRS	88.3%	38%	8	3
Minn. Teachers Ret. Ass'n	MN-TRA	76.8%	38%	8	3
Miss. Pub. Employees' Ret. Sys.	MS-PERS	61.7%	20%	10	2
Mo. Pub. School Ret. Sys.	MO-PSRS	85.8%	43%	7	3
Mo. State Employees' Plan	MO-SEP	72.6%	73%	11	8
Neb. Pub. Emps. Ret. Sys. School Ret. Sys.*	NE-PERS	88.0%	100%	8	8
Nev. State Pub. Employees' Ret. Sys.	NV-PERS	75.1%	100%	7	7
N.H. Ret. Sys.	NHRS	65.5%	100%	13	13
N.J. Pub. Employees' Ret. Sys.	NJ-PERS	38.2%	33%	9	3
N.M. Educ. Ret. Board	NM-ERB	64.0%	71%	7	5
N.M. Pub. Emps. Ret. Association	NM-PERA	77.0%	17%	12	2
N.Y.C. Teachers' Ret. Sys.	NY-TRS	68.0%	57%	7	4
N.Y. & Local Emps. Ret. Sys.	NYSLRS	97.9%	100%	1	1
N.Y. State & Local Police & Fire	NY-SLPF	99.0%	100%	1	1
N.Y. State Teachers' Ret. Sys.	NYSTRS	110.5%	60%	10	6
N.C. Local Gov't Employees' Ret. Sys.	NC-LGERS	98.1%	100%	13	13

Plan Name	Abbreviation	Funded Ratio	Appointed Ratio	Board Size	Appointed, Ex Officio
N.C. Teachers & State Emps. Ret. Sys.	NC-TSERS	94.6%	38%	13	5
Ohio Police & Fire Pension Fund	OH-OP&F	72.2%	33%	9	3
Ohio Pub. Emps. Ret. Sys.	OH-PERS	86.5%	36%	11	4
Ohio Schools Employees' Ret. Sys.	OH-SERS	69.2%	33%	9	3
Ohio State Teachers Ret. Sys.	OH-STRS	72.1%	36%	11	4
Okla. Pub. Emps. Ret. Sys.	OK-PERS	96.0%	100%	13	13
Okla. Teachers' Ret. Sys.	OK-TRS	70.3%	100%	13	13
Or. Pub. Emps. Ret. Sys.	OR-PERS	91.9%	100%	5	5
Pa. Pub. Sch. Employees' Ret. Sys.	PA-PSERS	54.4%	60%	15	9
Pa. State Employees' Ret. Sys.	PA-SERS	64.8%	82%	11	9
R.I. Emps. Ret. Sys.	RI-ERS	60.3%	60%	15	9
San Diego Cnty. Emps. Ret. Ass'n	SDCERS	78.6%	56%	9	5
S.F. City & Cnty. Employees' Ret. Sys.	SFERS	89.9%	57%	7	4
S.D. Ret. Sys.	SDRS	104.1%	19%	16	3
Tenn. Consol. Ret. Sys.	TCRS	96.4%	68%	19	13
Tex. Employees' Ret. Sys.	TX-ERS	64.4%	50%	6	3
Tex. Teacher Ret. Sys.	TX-TRS	78.4%	100%	9	9
Utah Ret. Sys.	URS	85.7%	100%	7	7
Va. Emps. Ret. Sys.	VRS	75.0%	44%	9	4
Wash. State Law Enforcement Officers' & Fire Fighters' Plan 1 & 2	WA-LEOFF	116.9%	100%	11	11
Wis. Ret. Sys.	WRS	102.7%	85%	13	11