

The Legal Intelligencer

Proxy Access: Looking Back at 2015 and Ahead at 2016

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During the 2015 proxy season, one of the most prominent governance topics was the submission of proxy access proposals by shareholders. New York City Comptroller Scott Stringer submitted shareholder proposals for proxy access on behalf of New York City pension funds to 75 companies for voting during the 2015 proxy season. In the fall of 2015, Stringer targeted 72 companies with proxy access proposals for voting during the upcoming 2016 proxy season—consisting of 36 new companies and 36 companies that received proposals last year, but had not yet enacted acceptable proxy access bylaws. In connection with his 2016 campaign, Stringer highlighted the fact that since November 2014, the number of companies with bylaws that contain a proxy access policy has increased from six companies to 115 companies. In light of this apparent success and Stringer's campaign, we expect that proxy access proposals will continue to be a hot topic into the future.

Basics of Proxy Access Bylaws and Trends from 2015

Any shareholder of a company is permitted to nominate individuals to serve as directors for election at the company's annual meeting. However, without proxy access, a nominating shareholder must not only follow the requirements set forth in the company's charter and bylaws, but such shareholder must also undertake the additional expense and effort of preparing its own proxy statement and proxy card for the nominated director, as well as conducting its own proxy solicitation for the nominated director. A proxy access bylaw provides shareholders with the opportunity to take advantage of using the company's proxy statement for purposes of a director nomination and thereby saving the expense and effort of conducting their own solicitations. As readers may recall, in August 2010, pursuant to its authority under the Dodd-Frank Act, the U.S. Securities and Exchange Commission (SEC) issued its final rule (Rule 14a-11) regarding shareholder proxy access, which was to be effective in November 2010 but was struck down in July 2011 by the U.S. Court of Appeals for the D.C. Circuit on the grounds that the SEC was arbitrary and capricious in promulgating the rule. Since that time, companies have begun to enact proxy access policies on their own, and shareholders have been submitting proposals to force their companies' hands.

More than 100 proxy access proposals were submitted during the 2015 proxy season, including the 75 proxy access proposals submitted by the New York City Comptroller's Officer. Seventy percent of the proposals received majority support. Interestingly, retail shareholders did not support proxy access proposals, and voted approximately 85 percent of their votes against these proposals, while institutional investors voted approximately 61 percent of their votes in favor of these proposals.

The following are key components of a proxy access bylaw, as well as trends for each of those components gleaned from the 2015 proxy season:

- **Ownership threshold.** A shareholder submitting a nominee for director election must reach a certain ownership threshold as a percent of the overall voting power of the company entitled to vote at the annual meeting in order to be eligible to present a nomination under a proxy access bylaw. Generally, the most commonly proposed ownership threshold during the 2015 proxy season was 3 percent, identical to the SEC's vacated Rule 14a-11. The proxy access bylaws that had been in place prior to the 2015 proxy season generally contained a 5 percent ownership threshold.
- **Aggregation.** The holdings of a certain number of shareholders may be aggregated together for purposes of reaching the required ownership threshold noted above. A majority of proxy access bylaws, including those that were in place prior to the 2015 proxy season and those that were proposed during the 2015 proxy season, provide for a group of either 10 or 20 stockholders who can combine their overall voting power in order to meet the required ownership threshold. Rule 14a-11 would have permitted an unlimited number of shareholders to be aggregated together to meet the required ownership threshold.
- **Duration of ownership.** Proxy access bylaws set a duration of time that a shareholder must own the company's stock in order to be qualified to nominate a director. Nearly all of the 2015 proposals, as well as previously approved proxy access bylaws, provide for a three-year holding period, a period identical to the vacated Rule 14a-11.
- **Number of nominees.** A proxy access bylaw limits the number of directors a qualifying shareholder may nominate. The limit is expressed either as a number of directors or a percent of the board as a whole. A majority of the 2015 proposals and pre-existing proxy access bylaws provide for a limit ranging from 20 to 25 percent of the board to be nominated by the qualifying shareholder. Rule 14a-11 provided that a qualifying shareholder could nominate the greater of one nominee or 25 percent of the board of directors.

Evaluation of 2016 Proxy Access Proposals

Where do ISS and Glass Lewis stand?

Neither Institutional Shareholder Services Inc. (ISS) nor Glass, Lewis & Co. have updated their respective 2015 voting guidelines with respect to proxy access proposals for the 2016 proxy season. The 2015 guidelines from ISS, which will continue for the 2016 proxy season, provide that ISS will recommend in favor of proposals that contain an ownership threshold no greater than 3 percent, minimal or no limit on aggregation, a duration of ownership no longer than three years, and a cap on nominees that is no less than 25 percent of the board. Glass Lewis continues to review proxy access proposals on a case-by-case basis, taking into account such factors as company size, board independence and diversity of skills, experience, background and tenure, the shareholder proponent and rationale for the proposal, responsiveness of board and management to other shareholders' rights policies, company performance, and other opportunities for shareholder action.

In January, ISS provided guidance on how it will evaluate a board's response to a proxy access proposal that was supported by a majority of a company's shareholders. ISS has stated that it may issue an "adverse recommendation" as to a company's board of directors in advance of the company's annual meeting if the proxy access bylaw that is implemented by such board of directors contains:

- An ownership threshold greater than 3 percent.
- An aggregation limit below 20 shareholders.
- A duration of ownership longer than three years.
- A number of nominees below 20 percent of the board.

Further, in the event that these items differ from the approved shareholder proposal, and the company fails to provide adequate disclosure regarding its shareholder outreach efforts, an adverse recommendation may be issued. ISS has also stated that it considers the following implementation items to be so limiting as to "effectively nullify" the proxy access right: (1) with respect to aggregation, that each individual fund within a mutual fund family be counted as a separate shareholder, and (2) an ownership requirement that would extend to post-meeting periods.

What might we see in 2016?

There are a variety of alternatives that companies may take with respect to proxy access in the 2016 proxy season. For example, companies and their boards of directors may elect to pre-emptively adopt a proxy access bylaw, thereby reducing the risk of a shareholder proposal that might include terms a board may not wish to include. A pre-emptive action by a board, however, does not insulate the company from the risk of receiving a shareholder proposal containing more

onerous terms than those enacted by the board. In such event, the company could attempt to exclude the shareholder's proposal under the "substantially implemented" standard.

Alternatively, a board of directors could submit its own proxy access proposal for a shareholder vote. Although this reduces the risk of the submission of a shareholder proposal, it does not eliminate it. While in the past such a shareholder proposal may have been excluded as "directly conflicting" with the management proposal, this may no longer be a viable argument in light of the SEC's limitation on the use of the "directly conflicts" exclusion during the 2015 proxy season in connection with the Whole Foods Market Inc. proxy. In December 2014, the SEC issued a no-action letter to Whole Foods Market permitting the company to exclude a shareholder proxy access proposal that "directly conflicted" with the management proposal based on Rule 14a-8(i)(9). In light of SEC chair Mary Jo White's direction to her staff to review the scope and application of this rule, the SEC withdrew the -no-action letter six weeks later, and refused to express additional views on the exclusion of shareholder proposals for the remainder of the 2015 proxy season. In October 2015, the SEC issued guidance that, going forward, it would consider whether a "reasonable shareholder could logically vote for both proposals" to determine whether a "direct conflict" exists between a stockholder proposal and a management proposal. The 2016 proxy season will be the first opportunity to observe how the SEC effectuates this guidance.

Is this Much Ado About Nothing?

Despite the fact that proxy access has been a hot topic for the past two proxy seasons, and has become accepted more rapidly than any other corporate governance issue in recent years, it is unclear who will seek to nominate directors by gaining access to a company's proxy by means of a bylaw provision. Activist investors are not likely to find the constraints of a proxy access bylaw appealing. Moreover, many proxy access bylaws allow only passive investors to seek access to the proxy, a category into which activists clearly do not fall. Further, many activist investors would not meet the holding period requirement, which, as discussed above, is most often a three-year period. In addition, the limitation on the number of directors that can be nominated would not enable an activist to gain meaningful control over a board of directors in the short term to direct the policies of the company, which is the goal of an activist investor. Outside of activist investors, it is difficult to imagine a group of 20 shareholders who would be able to meet the ownership threshold, particularly with respect to larger public companies. Regardless, however, of the "use" of a proxy access bylaw, many companies will find themselves subject to shareholder proposals for proxy access as such proposals have gained wide acceptance over the past year, and this trend shows no signs of -slowing.

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