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Proxy Access Revisited

The financial reform bill introduced by Senator Dodd earlier this month no longer mandates proxy access, but instead provides express authorization for the SEC to adopt proxy access rules should the SEC determine to do so. Thus, it would put the issue squarely back in the SEC's court. As we have said before (*see, e.g.,* "Proxy Access 2009: Will the Bad Economy Lead to Bad Governance?" and "Comments on the SEC's Proxy Access Proposals"), we believe that proxy access threatens significant damage to American corporations and boards and is premised on a number of unfounded assumptions. Proxy access is opposed by virtually every American company. It has the potential to wreak havoc with American business and to disrupt our nascent recovery from the financial crisis. The question is not whether boards should be subject to election contests, which are permitted today in every state. The question is whether it is good policy to facilitate an explosion in the number of election contests, to introduce the disruption of such contests as a regular and widespread feature of the corporate landscape every year, to allow political actors and special interest groups to bring election contests almost as easily as advisory proposals under SEC Rule 14a-8, and to deter board service on the part of the many responsible and effective directors who currently sit on the boards of our nation's public companies. We think the answer is clearly no.

While the Dodd bill now only authorizes proxy access, rather than mandating it, the statement in support of the bill asserts that proxy access "can help shift management's focus from short-term profits to long-term growth and stability." Experience suggests exactly the opposite. Increased shareholder activism has often resulted in pressure on boards to focus on short-term results. Hedge funds and other activists helped bring about the financial crisis by pushing boards into leveraged restructurings, buyouts and other short-term actions designed to boost short-term stock prices or offer shareholders a premium to sell their shares. Proxy access will give activists a powerful tool to increase this kind of pressure. Following the introduction of the Dodd bill, some proponents of proxy access have argued that the SEC will be able to monitor the proxy access process to ensure that it does not have a damaging impact. No one, however, has explained how the SEC would do this, or what resources the SEC has to perform such a monitoring function. These are issues that the SEC should keep in mind as it considers whether to move forward with proxy access.

Even if one believed that proxy access could offer some benefits, the best way to conduct an experiment of the costs and benefits is not to usurp the traditional role of state corporate law through a federally mandated set of proxy access rules, but rather to permit proxy access on a state-by-state, case-by-case, company-by-company basis. This is the approach that has successfully driven the development of corporate law throughout our history and there is no reason to depart from it now. Last year, Delaware amended its corporate law to permit shareholders or boards of individual companies to adopt bylaws implementing proxy access if they wish to do so. Other states could easily follow suit. In this way, proxy access could be introduced gradually, with customized variations, rather than the across-the-board, one-size-fits-all approach taken by the proxy access rules previously proposed by the SEC. At a minimum, proxy access raises issues of tremendous complexity, and both the basic principle as well as the details of implementation of proxy access have been debated intensely. A private-ordering

approach, particularly at the outset, would allow individual companies and their shareholders to decide if proxy access is desirable and, if so, to develop the best formulation for each company. If the experience with proxy access is good, over time it would likely be adopted on a more widespread basis. If, as we fear, it is disruptive and damaging, the experiment can be rolled back more easily. Although many unions, public pension funds and other activists have been pressuring the SEC for some time to adopt mandatory proxy access rules, it is hard to see how the one-size-fits-all approach could be preferable to this case-by-case approach.

In the event the SEC does decide to adopt a mandatory, across-the-board set of rules, the terms of those rules need to be revisited. The rules that the SEC proposed last year, in addition to having a number of technical issues that remain unresolved, set thresholds for the use of proxy access that are entirely too low and that invite abuse. Even many of the proponents of proxy access have suggested that the SEC should proceed with caution and set rules that limit the potential for harmful effects. Setting thresholds that would make it easy to bring an election contest immediately at every public company in the nation would be an extreme, rather than a cautious, approach to proxy access. If the SEC makes the determination to adopt proxy access, the thresholds should be designed, at least initially, to moderate the number of election contests that result from the new rules. Although we believe that proxy access is ill-advised, following the Delaware corporate law amendments, we issued a memo setting forth a model proxy access bylaw for companies or shareholders that might wish to consider such a bylaw. (*See* "Strategies for the New Reality of Shareholder Proxy Access.") Our model bylaw tries to set realistic thresholds and other terms that balance the desire for proxy access evidenced by some shareholders with the desire to avoid the worst of the potential harmful effects that we believe proxy access may produce.

We also believe that, if the SEC determines to adopt proxy access, there is no possible justification for preventing shareholders, on a company-by-company basis, from altering the default thresholds to make it either harder or easier to take advantage of proxy access at their particular company. Indeed, prohibiting shareholders from raising the thresholds for proxy access, should they choose to do so, is fundamentally at odds with the shareholder empowerment principle that underpins the case for proxy access. As part of a group of seven law firms, we have previously communicated this view to the SEC. (*See* "Supplemental Comments Submitted on the SEC's Proxy Access Proposals.")

In sum, we continue to believe that proxy access is an idea whose time has not come. (*See* "Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come.") Nonetheless, we are forced to recognize the political reality that the SEC may feel compelled to proceed with some kind of action on proxy access, either to facilitate shareholder proposals to adopt proxy access bylaws or to impose mandatory proxy access on all public companies. We hope that, in weighing these alternatives, the SEC does indeed proceed with caution, taking into account the significant risks and potential for harm that we have outlined in this and previous memos.

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