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Proxy Access 2009: Will the Bad Economy Lead to Bad Governance?

A tidal wave of anger over the economic climate – what Delaware Chief Justice Myron Steele has called a "populist frenzy" – has created a fertile political environment for recent efforts by three of five SEC Commissioners and Senator Schumer to federalize corporate law under the cloak of shareholder empowerment. Unfortunately for long-term shareholders, and the companies in which they have invested, there is no evidence linking the one-size-fits-all broad proxy access currently under consideration at the SEC and on Capitol Hill to better corporate governance or long-term performance. To the contrary, these proposals, if adopted, will likely exacerbate, rather than mitigate, the emphasis on short-term results that played a significant role in the economic crisis.

First, the SEC's proposal sets a minimum ownership threshold for shareholder eligibility to the corporate proxy entirely too low, at 1% of the shares of a company with a market capitalization greater than $700 million (with higher thresholds of 3% and 5% for smaller companies). Lowering the bar to 1% (and permitting even smaller shareholders to aggregate their stakes for purposes of achieving the 1% threshold), in contrast to the 5% threshold in our model access bylaw, gives activist and special interest holders a very low cost avenue to seek to influence board composition and corporate strategy. This low threshold will enable shareholder activists to create disruption at many companies each year, and reduce the willingness of qualified directors to serve.

Second, if there are more shareholder nominations than slots available, the SEC's proposal would give priority to shareholders who submitted their nominations the earliest, regardless of the size of the nominating shareholders' stakes. This contrasts with the approach of our model access bylaw which prioritizes nominations based upon the relative holdings of the nominating shareholders. Under the SEC's proposal, a long-term institutional investor holding well in excess of 5% of the company's equity for many years may have to suffer the negative effects of routine director election contests initiated by holders of 1% for only one year, and also lose the opportunity to avail itself of proxy access merely because the smaller holders beat a faster path to the corporate secretary's office. As a result, the SEC's proposal does not merely facilitate access for the occasional proxy access election contest, but rather creates incentives for routine election contests, as shareholders race to make access nominations in order to gain control over the process.

The SEC's proposal advances a mandatory proxy access regime that will not only weaken corporate boards, but also weaken the relative strength of long-term investors as compared to those investors that pursue short-term strategies often based on hollow financial engineering. The Delaware private-ordering approach to proxy access is more consistent with shareholder democracy in that it allows all the shareholders of each Delaware company to consider, debate and if appropriate adopt through shareholder action – rather than government fiat – shareholder access bylaws that suit the particular circumstances of each individual company and its shareholders. Accordingly, and as we have said before, we agree with the position taken by two of the SEC Commissioners, that a mandatory federal "one size fits all" rule is a serious policy error and the SEC should instead amend Rule 14a-8 to allow the issue to develop at the state law level.

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