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Proxy Access Proposals for the 2015 Proxy Season

A number of U.S. companies have recently received "proxy access" shareholder proposals submitted under SEC Rule 14a-8. Many of the recipients have been targeted under the New York City Comptroller's new "2015 Boardroom Accountability Project," which is seeking to install proxy access at 75 U.S. publicly traded companies reflecting diverse industries and market capitalizations. Underlying the Comptroller's selection of targets is a stated focus on climate change, board diversity and executive compensation.

These proposals are precatory and seek the submission to shareholders of a binding bylaw that would enable shareholders (or groups of shareholders) who meet specified criteria to nominate director candidates for election to the board and to have these nominees and their supporting statements included in the company's own proxy materials. If the proposal garners a majority shareholder vote at a company's 2015 annual meeting, it would not become effective unless and until the shareholders approve an implementing bylaw amendment at the company's 2016 annual meeting.

Companies that receive such proposals should first assess whether the shareholding, form and content requirements of Rule 14a-8 are satisfied. The current wave of proxy access proposals has evolved to cure most substantive vulnerabilities and, absent procedural defects, the SEC has generally been unsympathetic to proxy access exclusion requests. For example, the SEC has been unwilling to permit exclusion on the basis of "substantial implementation" where a company adopts its own version of proxy access that requires a higher shareholding amount or longer shareholding duration as compared to the thresholds proposed by the shareholder. However, the SEC has not yet ruled on whether it will permit exclusion where the company submits its own, more stringent proxy access proposal to a shareholder vote and thus creates a "direct conflict" with the shareholder's access proposal. At least one company, Whole Foods, has such an exclusion request currently pending before the SEC.

Assuming that exclusion is not available, the company's options for responding to the proposal include the following: (1) submit the proposal to a shareholder vote and make a board recommendation as to how shareholders should vote, (2) preemptively adopt a proxy access bylaw or submit a competing proxy access proposal with more stringent requirements, or (3) attempt to negotiate a compromise or alternative outcome with the shareholder proponent.

In weighing these options, a key consideration is whether the proposal is likely to receive majority shareholder support. If the proposal receives the support of a majority of votes cast, proxy advisory firms such as ISS (as well as members of the investment community) will expect the board to be appropriately responsive to the proposal, such as by adopting a compliant form of proxy access.

In the three years since the SEC first permitted Rule 14a-8 shareholder proposals on proxy access, approval rates have been mixed. Proposals that require a minimum stock ownership threshold of at least 3% of outstanding shares and a minimum continuous holding period of at least 3 years have had the most success, receiving a majority of votes cast at ten companies (including Verizon Communications (2013), CenturyLink (2013), Darden Restaurants (2013), Abercrombie & Fitch (2014) and Boston Properties (2014)). However, similar proposals failed to receive such a majority vote at six companies (including The Walt Disney Company (2013), Walgreen's (2014), Comstock Resources (2014) and Oracle (2014)). In total, proxy access proposals submitted by shareholders with a 3%/3 year threshold have received an average vote in favor of approximately 50.1% over the period from 2012-2014, although we note that such results are subject to context-specific factors (e.g., large insider positions, activist campaigns, etc.) and companies should consider their own circumstances and shareholder base when considering how to respond. Upcoming votes on proxy access at Cisco Systems on November 20 and at Microsoft on December 3 will provide further data points.

Many companies will likely conclude that this mixed record of voting results and delayed implementation of proxy access proposals weigh against taking action to proactively adopt proxy access. However, a few companies—such as Kilroy Realty in 2014, and Western Union and KSW in 2012—have taken the approach of adopting and defending their own, more stringent versions of proxy access in order to defeat a shareholder-sponsored version with lower thresholds. Alternatively, some companies have engaged in discussions with the shareholder proponent to ascertain whether it would support a different form of proxy access with more stringent requirements, such as a higher ownership threshold or longer holding period, in exchange for the company's support for a revised proxy access proposal or earlier implementation of proxy access. For example, Hewlett-Packard (2012) and McKesson (2014) negotiated withdrawals by agreeing to seek shareholder approval for proxy access in a future year, and Walt Disney (2014) settled with a shareholder proponent by agreeing to make other governance changes unrelated to proxy access.

While some proponents of proxy access claim that a "tipping point" of investor support has been reached, the reality is that many institutional investors do not reflexively support access proposals, even those crafted with thresholds mimicking the SEC's now-withdrawn 3% / 3 years formulation. Shareholders have many avenues for constructively influencing boards of directors, including with respect to board composition and, as we have long maintained, proxy access is not an optimal or even necessary element of corporate governance. In our experience, many major institutional investors are willing to engage in a case-by-case, fact-specific assessment of a company's circumstances in deciding how to vote on proxy access, even in the face of supportive proxy advisory firm recommendations (ISS and Glass-Lewis can generally be expected to recommend in favor of 3% / 3 year proxy access formulations).

We hope institutional investors will continue to be willing to take this case-by-case approach, despite the one-size-fits-all pressure being brought to bear by the New York City Comptroller. We believe companies that have developed good relationships with their shareholders, and that are able to demonstrate that effective governance policies are already in place, should be well-positioned to try to resist these proxy access proposals through further engagement and investor outreach.

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