

# Boardroom Perspectives™

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## Proxy Access—Making Sure You are Prepared for the 2016 Proxy Season

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**UPDATE (October 29, 2015):** On October 22, 2015, the Staff of the Securities and Exchange Commission's Division of Corporate Finance issued Staff Legal Bulletin No. 14H<sup>1</sup>, clarifying when a company may exclude a shareholder proposal on the basis that the proposal "directly conflicts" with a management proposal. Revisions to this Boardroom Perspectives to reflect the Staff's position set forth in the Bulletin are displayed in italicized type.

As the 2016 proxy season approaches, every public company should consider its position on proxy access and should have a plan for responding to a shareholder proxy access proposal. Based on lessons learned from the 2015 season, this issue of Boardroom Perspectives summarizes:

1. Actions a public company can take to prepare for receipt of a proxy access proposal.
2. Whether a company should wait and react to a shareholder proxy access proposal or preemptively adopt its own proxy access regime.
3. Alternatives available to a company following receipt of a proxy access proposal.

Proxy access is a mechanism that gives shareholders the right to nominate directors and have those nominees included in the company's annual meeting proxy statement. Proxy access gained significant momentum in 2015, with approximately 100 proposals submitted to shareholders and approximately 58% of those proposals being approved by shareholders.<sup>2</sup> Very likely a number of public companies will be subject to proxy access proposals during the 2016 proxy season.

### 1. Preparatory Actions in Anticipation of the 2016 Proxy Season

Companies can take a number of actions now in advance of the 2016 proxy season, including:

- Evaluating the company's shareholder base and understanding shareholders' voting policies and positions relating to proxy access.
- Engaging constructively with shareholders regarding proxy access in an effort to stave off or narrow shareholder proposals.
- Staying abreast of developing market practice for the specific terms of proxy access, particularly with respect to the size of nominating groups and caps on the number or percentage of shareholder-nominated candidates.
- Making sure the board and management are aligned with respect to appropriate responses to a shareholder proxy access proposal, as outlined below.

## **2. Taking a Wait-and-See Approach Versus Preemptively Adopting a Proxy Access Regime**

As the 2016 proxy season draws closer, companies will be confronted with the issue of whether to take a wait-and-see approach to proxy access or preemptively adopt a proxy access regime.

### **Option 1: Wait and see**

- Allows a shareholder to take the first step with respect to proxy access through a public pronouncement of its position on proxy access generally, in a private dialogue with the company or through submission of a proxy access proposal.
- Prevents a company from adopting or proposing a proxy access regime that is more liberal than shareholders might have proposed or one that is so restrictive it risks being rejected out of hand by shareholders.
- Provides time for the further development of market practice regarding the specific terms and implementation details of proxy access.
- Does not foreclose any of the company's options if the company receives a proxy access proposal, as outlined below.

### **Option 2: Preemptively adopt proxy access**

- May allow a company to adopt more restrictive provisions than those contained in a typical shareholder proposal, such as a limit on the size of nominating groups or a lower cap on the number or percentage of shareholder-nominated candidates.
- Does not bar shareholder proposals seeking to modify the terms of the adopted proxy access regime. During the 2015 proxy season shareholders approved proxy access proposals at four companies even though each of the companies had previously adopted their own form of proxy access.<sup>3</sup>
- May allow a board to obtain no-action relief from the Securities and Exchange Commission (SEC) permitting the board to exclude subsequently received proxy access proposals from its proxy materials on the ground that the proposal has already been substantially implemented. However, the SEC is unlikely to grant such no-action relief if the shareholder proposal differs in any material respect from the company-adopted regime.

## **3. Options After Receiving a Proxy Access Proposal**

After receiving a proxy access proposal, and assuming the proposal complies with the SEC's procedural requirements, a company has at least four available alternatives:

### **Option 1: Submit the shareholder proposal to shareholders without an alternative proposal from the company**

- Proxy access for a shareholder or shareholder group owning 3% or more of the company's common stock for at least three years is supported by many institutional investors, including T. Rowe Price, BlackRock, TIAA-CREF, CalPERS and CalSTRS.
- Retail shareholders are less likely to support proxy access — in 2015 just 15% of retail shareholders voted their shares in favor of proxy access proposals, while 61% of institutional shareholders voted their shares in favor of such proposals.<sup>4</sup>
- Institutional Shareholder Services (ISS) generally will recommend a vote in favor of proxy access proposals requiring a maximum of 3% ownership for three years as long as there are minimal or no limits on the ability of shareholders to aggregate their shares to satisfy the 3% threshold and the shareholders can nominate a number of nominees who, if elected, would constitute not less than 25% of the board. Glass, Lewis & Co. reviews proposals on a case-by-case basis.
- The company may be able to negotiate with the shareholder proponent to modify certain elements of its proposal in exchange for board support. These elements might include the number of shareholders whose shares can be aggregated to attain the 3% level, the number or percentage of directors that can be nominated and limitations on the ability of a shareholder or shareholder group to nominate directors in successive years.
- Companies should consider that combative responses to shareholder proposals may result in stronger shareholder support for the proposal.

## **Option 2: Implement the company's own form of proxy access and seek to exclude the shareholder proposal**

- As with a proxy access regime preemptively adopted by a company, this option may allow the company to receive SEC no-action relief allowing it to exclude the shareholder proposal on the basis that the company has substantially implemented the proposal.<sup>5</sup>
- As noted earlier, however, if the company adopts a proxy access regime that differs in any material respect from the shareholder proposal, the SEC may be more likely to deny the company's request for exclusion.
- The SEC has indicated it may be willing to exclude a shareholder proxy access proposal that includes no limitation on the number of shareholders whose shares can be aggregated to satisfy the 3% threshold even if the proxy access regime adopted by the company contains a reasonable limitation on the number of shareholders whose shares can be aggregated for this purpose. Specifically, General Electric Company was permitted to exclude a shareholder proposal by adopting its own proxy access bylaw even though the bylaw limited the nominating group to 20 shareholders while the shareholder proposal had no limit on the size of the nominating group.<sup>6</sup>

## **Option 3: Submit an alternative proposal to shareholders and seek to exclude the shareholder proposal**

- This option differs from Option 2 above because instead of actually adopting a proxy access regime, the company merely puts forth an alternative proposal for consideration by its shareholders.
- SEC no-action relief to exclude the shareholder proposal may be possible if the shareholder proposal "directly conflicts" with the company's own proposal.<sup>7</sup> For a majority of the 2015 proxy season, the SEC declined to express any views on whether shareholder proposals "directly conflicted" with company proposals.<sup>8</sup> *The SEC recently clarified this issue, stating that it will not "view a shareholder proposal as directly conflicting with a management proposal if a reasonable shareholder, although possibly preferring one proposal over the other, could logically vote for both proposals."*<sup>9</sup> *The SEC specifically noted that shareholder and management proxy access proposals with conflicting terms still sought a "similar objective," and accordingly shareholders could logically vote in favor of both proposals. As a result, apparently it will not be possible to seek exclusion of a shareholder proxy access proposal based on the inclusion of an alternative management proxy access proposal that has different, inconsistent or conflicting terms.*
- A company can also ask the shareholder or shareholder group to voluntarily withdraw its proposal if the company puts forth its own proposal.
- Excluding a shareholder proposal without an appropriate basis for doing so risks litigation and negative investor backlash. ISS will recommend a withhold vote on directors if a company omits a shareholder proposal without voluntary withdrawal, SEC no-action relief or a US district court ruling.


## **Option 4: Submit an alternative proposal and include the shareholder proposal**

- Competing proposals are potentially confusing to shareholders.
- In 2015, seven companies presented competing proposals. None of the company proposals were supported by ISS. Three of the company proposals passed, three of the shareholder proposals passed, and in one case both proposals were voted down. In no case did shareholders approve both the shareholder proposal and the management proposal.

## **4. After a Proxy Access Proposal is Approved by Shareholders**

If shareholders approve a proxy access proposal, the board will need to decide whether, how and when to implement the provision. If the proposal was a non-binding precatory proposal, which is the case with most shareholder proposals, the board will need to decide whether to implement the proposal exactly as proposed and approved by the shareholders or to deviate from the proposal in certain respects. We expect shareholder opinion and market practice regarding the implementation of proxy access proposals to continue evolving over the coming months, providing further clarity on the extent to which shareholders, as well the SEC and proxy advisory firms, are willing to accept proxy access terms implemented by the company that diverge from the terms approved by shareholders.

## Conclusion

Taking these various preparatory steps and understanding the alternatives available to a company if it receives a proxy access proposal should provide a framework for companies to confront any proxy access proposals they may receive in the upcoming 2016 proxy season. 



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<sup>1</sup> Available at <https://www.sec.gov/interps/legal/cfslb14h.htm>.

<sup>2</sup> Sharkrepellent.net, last accessed on September 29, 2015. 102 proposals have been submitted and 98 proposals have been voted on, with 57 proposals receiving a passing vote.

<sup>3</sup> CF Industries Holdings, Inc.; HCP, Inc.; Marathon Oil Corporation; The Priceline Group Inc.

<sup>4</sup> Broadridge Financial Solutions and PricewaterhouseCoopers, *2015 Proxy Season Wrap-up* (3rd ed. 2015), available at <http://media.broadridge.com/documents/ProxyPulse-Third-Edition-2015.pdf>.

<sup>5</sup> Pursuant to Rule 14a-8(i)(10) of the Securities Exchange Act of 1934 (Exchange Act).

<sup>6</sup> General Electric Company, SEC No-Action Letter (Mar. 3, 2015), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/kevinmaharrecon030315-14a8.pdf>.

<sup>7</sup> Pursuant to Rule 14a-8(i)(9) of the Exchange Act.

<sup>8</sup> In December 2014, the SEC granted no-action relief to Whole Foods Market, Inc. based on the inclusion of a management proxy access proposal requiring ownership of 9% for five years, permitting Whole Foods to exclude a shareholder proposal recommending proxy access at a 3% for three years threshold. Whole Foods Market, Inc., SEC No-Action Letter (Dec. 1, 2014), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/jamesmcritchie120114.pdf>.

On January 16, 2015, the SEC reconsidered its position and withdrew the no-action relief it granted Whole Foods in conjunction with announcing that it would review the application of Rule 14a-8(i)(9) and would express no views on the application of Rule 14a-8(i)(9) during the 2015 proxy season. See *Letter from the SEC's Division of Corporation Finance to James McRitchie* (Jan. 16, 2015), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/jamesmcritchiecheveddenrecon011615-14a8.pdf> and *Statement from Chair White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals* (Jan. 16, 2015), available at <http://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html#VLmTFXvQPn9>.

<sup>9</sup> Staff Legal Bulletin No. 14H (Oct. 22, 2015), available at <https://www.sec.gov/interps/legal/cfslb14h.htm>.