

Boardroom Perspectives™

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Proxy Access – Preparing for the 2017 Proxy Season

As shareholders continue to submit proxy access proposals, public companies may wish to consider proxy access and develop a response plan.

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Many public companies have received shareholder proxy access proposals in connection with their upcoming 2017 annual meetings and additional companies are likely to receive proposals in the coming months. Proxy access is a mechanism that gives shareholders the right to nominate directors for inclusion in the company's annual meeting proxy statement. Proxy access gained significant momentum in 2015 and 2016, with more than 200 proposals submitted to shareholders and approximately 58% of those proposals receiving shareholder approval.¹

Accordingly, public companies may wish to consider proxy access and develop a plan for responding to a shareholder proxy access proposal. Based on lessons learned in recent years, this issue of *Boardroom Perspectives* summarizes:

1. Actions a public company can take to prepare for receiving a proxy access proposal
2. Whether a company should wait and react to a specific 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

1. Preparatory Actions in Anticipation of the 2017 Proxy Season

Companies can take a number of actions now in advance of the 2017 proxy season, including:

- Evaluating the company's shareholder base and understanding shareholders' voting policies and positions relating to proxy access.
- Engaging constructively with shareholders on business and governance matters to build positive relationships and a mutual understanding of objectives, which may temper any perceived need for either the implementation of proxy access or amendments to a proxy access regime that has already been adopted and, at a minimum, establishes the groundwork for future resolution of any shareholder proposal.

Proxy Access: What's the Point?

Historically shareholders gained seats on a public company's board through either a negotiated agreement with the company or successful proxy fight. Proxy access provides a third route for gaining board representation. The purpose of proxy access is to permit significant, otherwise passive shareholders meeting certain requirements to include their director nominees in the company's proxy statement rather than requiring such shareholders to prepare and distribute their own proxy statement to shareholders. Proxy access is not intended as a new path to the boardroom for activists seeking to influence the company, and the prevailing proxy access construct specifically forecloses the ability of non-passive investors to use proxy access.

The real usefulness of proxy access to obtain board representation has yet to be determined. To date, the only shareholder to submit a proxy access nominee was deemed ineligible due to its past, very public, activist conduct with respect to the target company, and promptly withdrew its nominee. For shareholders that are more ambiguous or private about their intentions, eligibility for proxy access is uncertain, and will likely be determined on a case-by-case basis depending on the facts and circumstances. This scenario underscores the importance of the thoughtful consideration required for adoption and application of any proxy access regime, particularly while this area of corporate governance continues to evolve.

- 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.
- Ensuring 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 Proxy Access

As the 2017 proxy season draws closer, companies will again be confronted with the question of which approach to take with respect to proxy access. A company has at least two available alternatives:

Option A: 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
- Delays vulnerability to fix-it proposals seeking to modify and enhance the terms of an adopted proxy access regime that proponents perceive to be off-market or overly restrictive (see box, *New in 2017: Shareholders Submit “Fix-It” Proposals*)
- Is consistent with market practice for all but the largest cap companies — only 12% of Russell 3000 companies have adopted proxy access²
- Does not foreclose any of the company’s options if the company receives a proxy access proposal, as outlined below

Option B: Preemptively adopt proxy access

- Does not bar fix-it shareholder proposals seeking to modify the terms of the adopted proxy access regime, requiring the board to revisit the bylaw
- Will likely not permit a board to obtain no-action relief from the Securities and Exchange Commission (SEC) to exclude fix-it proposals from the company’s proxy materials on the ground that the proposal has already been substantially implemented,³ unless the company amends its proxy access regime to adopt some of the proposal’s suggested amendments⁴

3. Options After Receiving a Proxy Access Proposal

After receiving a shareholder proposal regarding proxy access, and assuming the proposal complies with the SEC’s procedural requirements, a company has at least three available alternatives:

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

- Many institutional investors, including T. Rowe Price, BlackRock, TIAA-CREF, CalPERS and CalSTRS support proxy access for a shareholder or shareholder group owning 3% or more of the company’s common stock for at least three years.

New in 2017: Shareholders Submit “Fix-It” Proposals

Traditionally, after a company adopts the crux of a shareholder proposal, the proponent of the proposal moves on to another company or to another governance issue. However, during the second half of 2016, proponents of proxy access proposals that were dissatisfied with certain proxy access terms adopted by companies declined to move on and opted instead to submit new shareholder proposals requesting that the company amend the offensive terms. These “fix-it” proposals, each of which typically suggests multiple, discrete changes, most frequently address and request:

- **Cap on Aggregating Shareholders**- the removal of the cap on the number of shareholders that can aggregate their shares to meet the minimum ownership threshold.
- **Cap on Board Nominees** – an increase in the number of shareholder-nominated candidates eligible to be included in the company’s proxy materials to 25% of the board (with a minimum of 2).
- **Re-nomination Restrictions** – the elimination of restrictions on the re-nomination of directors in future years based on the percentage of votes received.
- **Post-Meeting Ownership Requirements**– the elimination of the requirement for a nominating shareholder to hold its shares for a period of time following the annual meeting.
- **Loaned Shares as “Owned”** – the inclusion of loaned shares among the shares counted to satisfy the percentage ownership threshold so long as the shares are recallable within a specified timeframe

To date, very few of the fix-it proposals have received shareholder approval, particularly where the target company had implemented proxy access for shareholders with 3% stock ownership for three years, rather than at higher thresholds. As proxy season progresses, we will continue to monitor investor reaction to fix-it proposals.

- However, retail shareholders continue to be less likely to support proxy access — in 2016 just 15% of retail shareholders voted their shares in favor of proxy access proposals, while 60% of institutional shareholders voted their shares in favor of such proposals.⁵
- The identity of the proponent matters. Shareholders are less likely to vote in favor of proxy access proposals submitted by frequent shareholder proposal proponents John Chevedden, James McRitchie and William Steiner; shareholders approved less than 31% of their proposals, while shareholders approved more than 66% of proposals submitted by New York City Comptroller Scott Stringer and the New York City Pension Funds.⁶
- 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 the proposals impose minimal or no limits on the number of shareholders whose shares can be aggregated 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.
- Note that combative responses to shareholder proposals made by credible proponents may result in stronger shareholder support for the proposal.

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

- The company may be able to negotiate with the shareholder proponent to withdraw its proposal in exchange for the board's adoption of a proxy access regime with certain modified terms, including 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.
- In lieu of a negotiated withdrawal, the company may be able to obtain SEC no-action relief allowing the company to exclude the shareholder proposal from the company's proxy statement on the basis that the company has substantially implemented the proposal.⁷
- During the 2016 proxy season, the SEC indicated that if a company adopts a proxy access regime with an ownership threshold matching that of the shareholder proposal (typically 3% for three years), then the SEC may be willing to permit exclusion of the shareholder proxy access proposal from the company's proxy statement that otherwise proposes terms that vary slightly from the regime adopted by the company.⁸


Option C: Submit the shareholder proposal to shareholders *along with* an alternative proposal from the company

- This option differs from Option B above because instead of actually adopting proxy access, the company merely puts forth an alternative, competing proposal for shareholders to consider.⁹
- In 2015 and 2016, 12 companies presented competing proposals. Six of the company proposals passed, five 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.
- A company can 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.

4. After Shareholders Approve a Proxy Access Proposal

If shareholders approve a proxy access proposal, the board may discuss 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 may consider, among other options, whether to implement the proposal exactly as proposed and approved by the shareholders or to deviate from the proposal in certain respects and potentially face future fix-it proposals. We expect shareholder opinion and market practice regarding the implementation of proxy access proposals to continue to evolve over the coming months and years, providing further clarity on the extent to which shareholders, as well as the SEC and proxy advisory firms, are willing to accept proxy access terms that a company implements which diverge from the terms that shareholders approved or requested.

Conclusion

Taking appropriate preparatory steps and understanding the alternatives available upon receipt of a proxy access proposal should provide a framework for companies to address the issue of proxy access in the upcoming 2017 proxy season. 



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- ¹ Sharkrepellent.net, last accessed on January 11, 2017. At meetings in 2015 and 2016, 212 proposals have been submitted to shareholders and 207 proposals have been voted on, with 120 proposals receiving a passing vote.
- ² Sharkrepellent.net, last accessed on January 11, 2017.
- ³ Pursuant to Rule 14a-8(i)(10) of the Securities Exchange Act of 1934 (Exchange Act). See H&R Block, Inc., SEC No-Action Letter (Jul. 21, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/mcritchieyoung072116-14a8.pdf>. Microsoft Corporation, SEC No-Action Letter (Sept. 27, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchie092716-14a8.pdf>. Apple Inc., SEC No-Action Letter (Oct. 27, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchieapple102716-14a8.pdf>. Whole Foods Market, Inc., SEC No-Action Letter (Nov. 3, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchiewhole110316-14a8.pdf>.
- ⁴ See NVR, SEC No-Action Letter (Mar. 25, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/comptrollercitynyrecon032516-14a8.pdf>. Oshkosh Corporation, SEC No-Action Letter (Nov. 4, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/johncheveddenoshkosh110416-14a8.pdf>.
- ⁵ Broadridge Financial Solutions and PricewaterhouseCoopers, *2016 Proxy Season Review* (3rd ed. 2016), available at <http://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-and-broadridge-proxypulse-2016-proxy-season-review.pdf>.
- ⁶ Sharkrepellent.net, last accessed on January 11, 2017. At meetings in 2015 and 2016, 45 proposals have been submitted to shareholders by John Chevedden, James McRitchie and William Steiner and 43 proposals have been voted on, with 13 proposals receiving a passing vote, whereas 80 proposals have been submitted to shareholders by the New York City Retirement Systems and 80 proposals have been voted on, with 53 proposals receiving a passing vote.
- ⁷ Pursuant to Rule 14a-8(i)(10) of the Securities Exchange Act of 1934 (Exchange Act).
- ⁸ See Newell Rubbermaid Inc., SEC No-Action Letter (Mar. 9, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/johncheveddennewell030916-14a8.pdf>. See also Fluor Corporation, SEC No-Action Letter (Mar. 3, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/mcritchieyoung030316-14a8.pdf> and Xylem Inc., SEC No-Action Letter (Mar. 3, 2016), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/johncheveddenxylem030316-14a8.pdf>.
- ⁹ Note that it is not possible for a company to obtain SEC permission to exclude a shareholder proxy access proposal based on the argument that the shareholder proposal “directly conflicts” with a proxy access proposal put forth by the company itself, pursuant to Rule 14a-8(i)(9) of the Exchange Act. Specifically, the SEC has stated that shareholder and management proxy access proposals with conflicting terms still seek a “similar objective,” and accordingly shareholders “although possibly preferring one proposal over the other, could logically vote for both proposals.” See Staff Legal Bulletin No. 14H (Oct. 22, 2015), available at <https://www.sec.gov/interps/legal/cfs14h.htm>.