Key Takeaways

Skadden

Proxy Access: Latest Developments

Contacts

Marc S. Gerber
202.371.7233
marc.gerber@skadden.com

Richard J. Grossman
212.735.2116
richard.grossman@skadden.com

Four Times Square
New York, NY 10036
212.735.3000

1440 New York Avenue, NW
Washington, D.C. 20005
202.371.7000

On September 17, 2015, Skadden presented a webinar titled "Proxy Access: Latest Developments." The panelists were Art Crozier, Chairman of Innisfree M&A Incorporated; Mike Garland, Assistant Comptroller for Corporate Governance and Responsible Investment, Office of New York City Comptroller Scott M. Stringer; and Marc Gerber and Rich Grossman, partners in Skadden's Mergers and Acquisitions Group.

The 2015 Proxy Season

Following a brief overview of proxy access — including the SEC's 2010 rule that was vacated on administrative law grounds, the initial success of proxy access shareholder proposals from 2012-14 and the launch of the New York City comptroller's proxy access campaign — the panel discussed the results of the 2015 proxy season and the more than 113 proposals that had been submitted to companies to date. Mr. Gerber observed that at almost two-thirds of the companies 3 percent proxy access was either adopted, announced or proposed by management in response to the shareholder proposal or the shareholder proposal received majority support and was likely to be implemented. Another 10 companies had 3 percent shareholder proposals fail, but either indicated a willingness to adopt proxy access at a to-be-determined threshold, or adopted, announced or proposed 5 percent proxy access. There were only about 25 companies where a 3 percent proposal failed, and many of those were "near misses" with shareholder support well over 40 percent of votes cast.

Mr. Crozier noted that two main factors were driving the differences in outcomes: shareholder composition and company performance. He explained that Vanguard is looking for 5 percent proxy access and generally has voted against 3 percent shareholder proposals. In addition, Fidelity is opposed to all proxy access proposals, even management proposals. When large positions are held by these two investors, a proxy access shareholder proposal had a harder road to travel. On company performance, Mr. Crozier explained that companies with a stronger TSR performance over a one- to three-year period generally fared better in their votes.

Mr. Crozier further noted that despite recent investor rhetoric, the picture is not one of inevitability when looking at the voting results. However, since there is a growing belief that widespread adoption of proxy access is likely, he commented that it might be advisable to "jump on the bandwagon now."

Mr. Garland explained that he and others at the New York City pension funds were not sure what to expect when they launched their campaign, but that their minimum goal was to change the debate around proxy access. In that respect, he views the campaign as a tremendous success. The tenor of the discussions around proxy access has fundamentally changed from whether to adopt proxy access to the specific terms of a workable access bylaw, and he suspects votes will continue to creep up going forward. Mr. Crozier noted that while a number of institutions did not have a firm policy on proxy access during the 2015 policy season, we will probably see several more institutions adopting voting guidelines that are supportive of 3 percent proxy access.

Potential Users of Proxy Access

Next, Mr. Gerber asked panel members for their thoughts on likely users of the process. Mr. Grossman responded that proxy access is not likely to be a tool for hedge fund activists. For one, many activists probably will not meet the three-year holding requirements. In addition, activists generally like to keep the threat of a control fight in their pockets, which they cannot do with proxy access, and generally like to send out their own proxy cards. Thus, the most likely users are public pension funds and long-term shareholders who are not happy with specific issues, such as performance, governance provisions and other matters that prompt them to think greater shareholder representation is needed on the board. Mr. Crozier agreed with this assessment, adding that large fund managers will not want to take positions publicly against management. One could, however, see a small group of shareholders using proxy access as a pressure tactic.

Mr. Garland noted further that he anticipated that proxy access would be rarely used, even among the public pension funds. He emphasized that the holding requirements are difficult to achieve and expects that it will take a significant unaddressed concern, if not a crisis, in order to galvanize support for submitting a proxy access nominee. Nevertheless, he added, the specter of proxy access will make boards more responsive.

Board Adoption vs. Shareholder Vote

Mr. Gerber asked the panelists for their thoughts on whether there were benefits or drawbacks to board adoption versus submitting the bylaw to a shareholder vote. Mr. Garland noted that the New York City pension funds will support boards that adopt a bylaw unilaterally if that bylaw is consistent with the SEC's vacated rule. Mr. Grossman added that so long as a board adopted bylaw is within the middle of the fairway, there should be no need to put the bylaw up to a shareholder vote. Moreover, putting a bylaw up to a vote could result in the company receiving more pressure from certain small, but vocal, investors or ISS to adjust the terms of its bylaw, particularly with respect to aggregation limits and creeping control provisions. Thus, there may be a slight advantage to adopting unilaterally. Mr. Crozier agreed with Mr. Grossman's assessment, noting that we may see more unilateral adoptions once ISS comes out with its 2016 voting policies on what constitutes implementation of a proxy access shareholder proposal from companies seeking greater flexibility than they would have adopting proxy access after a successful shareholder proposal.

Proxy Access Terms

Ownership Requirements

The panel then shifted to discussing the terms of a potential proxy access bylaw. Starting with a discussion of ownership requirements and the question of 3 percent versus 5 percent required ownership, Mr. Grossman noted whether a 5 percent requirement is still a viable alternative will be a case-by-case determination, and the key for any company will be to look at its shareholder base. He further explained that the trend has clearly been toward 3 percent proxy access, and that merely adopting a 5 percent bylaw will not guarantee that a company will not get a shareholder proposal. However, if a company does adopt a 5 percent access bylaw, there may be a lower likelihood of receiving a future shareholder proposal.

Mr. Garland referred to 5 percent as the illusion of access. He noted that the SEC looked at a 5 percent threshold for smaller companies and concluded that it was not a viable threshold, even for a larger group of shareholders. While he is not sure what actions investors will take with respect to companies that adopt proxy access at 5 percent, he does not believe that a 5 percent threshold will survive over time.

Mr. Gerber noted that one of the most significant points of contention, at least for the Council of Institutional Investors (CII), is a limit on the number of shareholders who can aggregate their shares to meet the required ownership threshold. Some investors believe a reasonable limit is permissible, and market practice appears to have settled on an aggregation limit of 20. Mr. Crozier explained that from a company perspective, a reasonable limit is desirable, given the practical difficulties and costs that a company would face if there were a contested election using proxy access. If the proponents had to cast a wide net to obtain enough holders to meet the ownership and holding requirements, it is a sign that there is not wide support for the proponents, yet the company will still face considerable cost and distraction in the election. Mr. Garland noted that the SEC considered and rejected aggregation limits. While investors may be somewhat sympathetic to the administrative burden that overly large groups of shareholders could present, he explained that the 20 largest public pension funds rarely hit a 3 percent ownership level collectively, so the 20 person limit raises real concerns.

Mr. Gerber questioned whether the trend toward counting related funds as one shareholder for the purpose of aggregation alleviates some of the concern around aggregation limits. Mr. Garland observed that the concern, while still present, is certainly more acute where companies don't count related funds as a single shareholder.

Rounding out the ownership discussions, the panel discussed the need to clarify that shares that are loaned will still count as continuously owned for purposes of the ownership requirements, an issue identified by CII in its August policy statement. While some bylaws are silent on this issue, the trend is to explicitly count loaned shares, subject to some conditions on the ability to recall the shares or the actual recall of the shares. Noting that counting loaned shares toward the continuous ownership requirement is consistent both with the SEC's vacated rule and the idea of long-term ownership, Mr. Garland emphasized that it is important that bylaws be explicit in this regard. The New York City pension funds are supportive of a requirement that shares be recallable on five business days' notice and are comfortable with a further requirement that shares actually be recalled.

Cap on Nominees

The panel next considered the number of board seats available for proxy access. Mr. Gerber explained that allowing shareholders to nominate candidates for up to 20 percent of the board is most common, with two companies specifying that shareholders will be permitted to nominate at least two nominees. The next most common cap is 25 percent of the board. For the typical public company board, any of these formulations achieves the same result: shareholders will be able to have two access nominees. With respect to which cap is most appropriate, Mr. Garland noted that a 25 percent cap is the best practice and the cap he would prefer to see in all bylaws, but that a 20 percent cap may be fine for larger boards. The principle is generally to allow at least two access nominees.

Mr. Gerber noted that perhaps the bigger question surrounding caps on proxy access nominees relates to "creeping control," and the concern of companies that proxy access could be used in sequential years to gain control of the board. Mr. Grossman explained that companies have addressed this concern in a few different ways, with the most common approach being to count any successful proxy access nominee whom the board renominates (at least for some period of time) toward the cap. Mr. Garland added that he believes creeping control is a valid concern, but that he is uncomfortable with this majority approach. Rather than reducing the number of seats available for other shareholders to nominate directors, he believes a more appropriate approach would be to restrict a successful nominating shareholder from utilizing proxy access in the immediately succeeding years.

Mr. Gerber shifted the discussion to another concern — what happens when a traditional proxy fight takes place simultaneously with a proxy access election contest? In this instance, a company would be faced with a "two-front war." Mr. Crozier expanded on this concern, explaining that such a two-front war could cause significant confusion among shareholders, particularly if there is large retail ownership. Further, without a universal ballot, allowing proxy access when there is also a full board proxy fight puts the company at a tactical disadvantage, as anyone who votes for a proxy access nominee is, by definition, not voting for all of the management nominees. The dissident in a proxy fight doesn't have that disadvantage. Thus, when there are proxy access nominees on the company's card, a dissident could get more directors elected than they otherwise would have due to the draining of support from the management nominees. As a result of these concerns, most companies have provided in their bylaws that proxy access will be unavailable in the event that any directors are nominated by shareholders outside of proxy access.

Mr. Garland disagreed that cutting off proxy access in the event of a traditional proxy fight is necessary, noting that the SEC had considered this issue in its proxy access rulemaking and had decided not to disallow proxy access in such circumstance.

Other Terms

The panelists next turned to a discussion of two other somewhat controversial terms of proxy access bylaws: (1) representations with respect to continued ownership of a company's shares after the applicable annual meeting and (2) provisions providing that nominees who fail to receive a minimum level of support will be ineligible to be proxy access nominees in subsequent years. Mr. Gerber explained that CII and other investors are clear that a representation that the nominating shareholders *will* continue to own the shares is problematic, pointing to fiduciary duty concerns, among others. However, a number of bylaws require a representation as to the shareholder's intentions regarding continued ownership, which would not require any commitment to hold the shares. Mr. Grossman added that there is a rationale for requesting information about a shareholder's intentions, namely that shareholders might find that information material to their voting decision. In addition, the SEC's vacated rule required shareholders to disclose their intentions with respect to continued ownership, so we may see companies continue to adopt such a requirement.

With respect to future nominee ineligibility, Mr. Gerber explained that CII does not believe a nominee should be required to achieve any minimum level of shareholder support to be eligible to be renominated in a subsequent year. Yet a minimum support threshold for renomination is virtually a universal provision. Mr. Gerber questioned why this provision is so disfavored, given that it seems shareholders would not want to rerun an unsuccessful candidate, and companies do not want to be subjected to repeat election contests from candidates who are not viable prospects. Mr. Garland responded that the main concern is that the 25 percent level of support that is most often required seems too high, and he noted that these future ineligibility provisions could become a tertiary issue if lower thresholds were utilized.

Outlook for the 2016 Proxy Season

The panelists next discussed the outlook for the 2016 proxy season. Mr. Gerber noted that the New York City comptroller referred to its campaign as a multiyear project, and other institutional and individual investors have submitted their fair share of proposals and seem likely to continue to do so. Mr. Garland agreed that the proposals would continue and noted that while he couldn't give specifics regarding the New York City pension funds' campaign for the upcoming season, he can say that they are still looking to expand and are happy to talk to companies who are contemplating adopting proxy access bylaws even before the next proxy season. Mr. Crozier added that he is very confident in saying that there will be more proposals in 2016 than there were in 2015. There is a groundswell of support developing for the concept, and the level of success will attract other proponents.

With these predictions in mind, Mr. Gerber questioned whether companies should consider adopting access proactively, before receiving a proposal, or whether companies should wait and react once they get a proposal (but before the annual meeting). Mr. Grossman responded that companies who act now may have a unique opportunity to retain some flexibility in their proxy access provisions. Shareholder views are not yet uniform and are still evolving, and the next generation of proposals may be more prescriptive than the last. Adopting sooner rather than later could enable a company to put the more desirable provisions into its proxy access bylaw and still ward off a shareholder proposal.

Mr. Crozier added that it is important to remember that ISS guidelines will be issued in November. If those guidelines are strict when it comes to what constitutes implementation of a successful shareholder proposal, there may be an impetus to move sooner.