The Next Wave of Proxy Access Proposals: What Issuers Should Know and How They Can Prepare

WSGR ALERT

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The Comptroller of the City of New York, who oversees pension funds with a combined $160 billion in assets, recently submitted proxy access shareholder proposals at 75 U.S. public companies as part of its Boardroom Accountability Project.[1] These 75 companies, representing a wide range of industries and market capitalizations, were targeted based on three "priority issues": climate change, board diversity, and executive compensation.

"Proxy access" proposals seek to provide shareholders with a mechanism for placing their nominees for director in a company's proxy statement and on its proxy card, thereby avoiding the cost to a shareholder of sending out its own proxy statement. Under a typical proxy access bylaw, shareholders must hold a specified amount of stock in the company (e.g., 3 percent) for a certain period (e.g., 3 years), in addition to meeting other procedural requirements. Proponents of proxy access argue that it provides shareholders with a cost-effective means of running their own candidates for director, providing all shareholders with greater ability to shape the composition of the board.

The New York City Comptroller's proposals are precatory, meaning that, if approved, they constitute a *request* from shareholders to a company's board that it adopt, and present to shareholders for approval, a proxy access bylaw. Approval of such a proposal by shareholders *does not* implement proxy access at a company. If the Comptroller's proposal passes, a company's board is entitled, in the exercise of its business judgment, to decline to adopt a proxy access bylaw. But, if the board fails to act on (that is, fully implement) a shareholder proposal that receives the support of a majority of the votes cast, then Institutional Shareholder Services (ISS) is likely to recommend withhold/against votes on individual directors, committee members, or the entire board at future annual meetings. Where the proposal passes and a company's board wishes to adopt proxy access, it would either propose amendments to its bylaws and submit those amendments to a binding shareholder vote or unilaterally adopt amendments to the bylaws (since the board typically has the authority to amend a company's bylaws without the need for shareholder approval).

Sustained "private ordering" efforts to implement proxy access through Rule 14a-8 proposals have existed in some form since proposed Rule 14a-11—with its mandatory proxy access for all U.S. public companies—was vacated by the D.C. Circuit Court of Appeals in 2011.[2] Rule 14a-11, in turn, was the product of a multiyear proxy access effort by the Securities and Exchange Commission (SEC),[3] with specific authorization for the SEC to adopt proxy access included in the Dodd-Frank Act.[4] By now, proponents have worked through most of the substantive infirmities in prior proxy access proposals and it is expected that, absent a procedural defect or unique circumstance at a particular company, the Comptroller's proposals will be required to be presented for a shareholder vote at most of the companies targeted. ISS has generally supported proxy access proposals with a "3 percent for 3 years" formulation—similar to that used by the Comptroller—in the past, and it is likely to support the Comptroller's proposals and other similar proposals submitted to other companies this year.

Even with the support of ISS, proxy access proposals substantially similar to the Comptroller's have a mixed record. In 2014, 10 substantially similar proposals were submitted to a shareholder vote but only five were approved by shareholders. Even though all 10 of the proposals were supported by ISS, these results demonstrate that institutional investors are willing to examine proxy access proposals on a case-by-case basis in light of the circumstances at each company and are not robotically following voting recommendations.

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[1] https://comptroller.nyc.gov/boardroom-accountability.
[2] http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-proxy-access-rules.htm.
[3] http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert_proxy_access.htm.
[4] http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert_dodd_frank2.htm.

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Reviewing the Rule 14a-8 Process

In light of the publicity received by the Comptroller's campaign, we thought it would be helpful to review the general process to be followed following the receipt of any Rule 14a-8 proposal. Whenever a company receives a Rule 14a-8 shareholder proposal, it must:

- *Assess any procedural exclusions.* Review the proposal to determine whether it satisfies all of the procedural requirements of Rule 14a-8 (e.g., not more than 500 words, the proponent has provided sufficient evidence of its share ownership for at least one year, etc.) and, if it does not, notify the proponent within 14 days of receipt. The importance of this step cannot be overemphasized: even sophisticated proponents at times submit proposals with procedural defects.

- *Assess shareholder composition*. Review the company's shareholder composition and evaluate the likelihood, in the context of the particular circumstances at the company, that a shareholder proposal would prevail if taken to a vote of shareholders. Although recommendations from ISS and Glass Lewis may be influential, they are not outcome-determinative.

- *Assess submission of a no-action request*. Review whether the SEC granted no-action relief with respect to the same or a substantially similar proposal in the past and determine whether a no-action request is warranted. Even where the weight of precedent is against the company, novel circumstances or new arguments can, at times, result in different outcomes in the no-action process. For example, Whole Foods is currently seeking no-action relief to exclude the Comptroller's proxy access proposal on the basis that it conflicts with its own (more stringent) proxy access proposal appearing on the ballot at the 2015 annual meeting.

- *Consider options*. Would the proponent be willing to withdraw the proposal in exchange for the company taking other action? For example, a proxy access proposal was withdrawn at Walt Disney in 2014 in exchange for unrelated governance changes. Not every proponent will negotiate with companies, but it is a strategy that should not be overlooked.

- *Prepare opposition statement and shareholder outreach*. If a shareholder proposal will be included in the company's proxy statement, care should be taken in preparing the company's position and, if applicable, opposition statement (which, unlike the proponent's supporting statement, is not subject to a word count limit). A copy of the opposition statement must be provided to the proponent no later than 30 calendar days before the company files its proxy statement. In addition, a comprehensive shareholder outreach program should be developed that takes into account the voting policies of the company's major shareholders and that persuasively gives the company's perspective on the proposal.

If you have received a shareholder proposal or would like more information, please contact Steve Bochner (sbochner@wsgr.com), Katie Martin (kmartin@wsgr.com), Warren de Wied (wdewied@wsgr.com), David Berger (dberger@wgr.com), Lisa Stimmell (lstimmell@wsgr.com), or any member of the corporate law and governance practice at Wilson Sonsini Goodrich & Rosati.

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