Proxy access: Moving to center stage?

A real shift may be underway in how board elections are conducted for public companies.

BY DOUG RAYMOND

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Although the directors of a public company are elected by, and consequently theoretically answerable to, their shareholders, many have argued that these shareholder elections are not conducted on a level playing field, but instead significantly favor the incumbents. When the incumbent directors run for re-election, the company runs their campaign, paying to prepare and distribute the proxy statement to its shareholders and then soliciting proxies to vote in favor of the incumbents. By comparison, in the past challengers had to prepare and manage their own election campaign, often at significant cost. Perhaps more importantly, the incumbent's campaign has the imprimatur of corporate approval, relegating challengers to the status of a "dissident" or "insurgent."

Recognizing this disparity, many voices, including the SEC, have called for leveling the playing field by giving certain long-term, significant stockholders equivalent ability to nominate director candidates using the company's proxy statement. The SEC addressed this matter of proxy access in 2010 when it adopted proxy access on a "3-3-25" basis, i.e., holders of 3% of a company's shares for at least three years could use company proxy materials to seek election for up to 25% of the board members (a "3-3-25" standard).

Although this initiative was later invalidated as having exceeded the SEC's authority, the issue has not gone away. Last year, the New York City Comptroller submitted 3-3-25 shareholder proxy access proposals to 75 different publicly traded companies. During the last proxy season, over 100 proxy access proposals, most following the 3-3-25 pattern, were submitted as shareholder proposals and about 60% of those voted on were approved by shareholders.

This level of support for these proposals suggests that proxy access proposals will not quickly fade away. This may be the beginning of a real shift in how board elections are conducted for public companies.

The landscape of the proxy access movement has been complicated by the SEC's pullback from its previous position that a company may in certain circumstances exclude a shareholder proposal, such as one dealing with proxy access, from its proxy statement. The usual basis for excluding such proposals was that the company had itself proposed or even adopted a similar proposal, even if it had done so after having received the shareholder proposal. Before the SEC backed away from this policy, which it says is currently under review, a board could avoid taking any action on proxy access unless such a proposal were received. In that event, the board could effectively neutralize the proposal not only by soliciting votes against it but also by instead substituting its own proposal that might be more rigorous than the shareholder proposal.

Unless and until the SEC clarifies its position on such dueling proposals, companies face the prospect of fighting a campaign against what could be an unfavorable proxy access approach, or going head-to-head with such a proposal by also submitting its competing proposal for a vote. In either case, if shareholders approve a 3-3-25 proposal that is not implemented by the company, shareholders could oppose the election of some or all of the directors for ignoring the majority vote.

As boards consider whether they still can take a "wait and see" approach on proxy access, they should consider what proxy access approach, if any, they would approve. The 3-3-25 standard was the one most often proposed last year by shareholders, and has been supported by a variety of institutional shareholders. If a board-adopted approach strayed too far from that standard, for example by requiring 5% ownership, shareholders might still submit and support a less stringent standard.

It is too soon to know how much flexibility companies will have to adopt alternative standards without triggering a challenge by institutional shareholders or their advisors. But for boards willing to work within the 3-3-25 framework (or whichever becomes an accepted standard), there are a number of details that still can be important for corporate governance but which may not trigger significant opposition. These include, among other things, the number of shareholders permitted to aggregate their shares to satisfy the ownership test, and how to respond to director nominations not seeking to be included in the proxy statement.

Last year, the NYC Comptroller's corporate targets were reportedly selected on the basis of concerns regarding board diversity, environmental responsibility, and executive compensation. Looking ahead, even companies with sound policies in those areas may become the next targets. The strength of the proxy access trend paired with the uncertainty of how the SEC will treat competing proposals suggests that boards should prepare now for events that may come more quickly than they currently expect. ■

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