Columbia Law School

Scholarship Archive

Ira M. Millstein Center for Global Markets and Corporate Ownership

Research Centers & Programs

2016

Proxy Access 2.0: A Recap on 1.0 and the Economic Analysis

Ira M. Millstein Center for Global Markets and Corporate Ownership
Columbia Law School

Follow this and additional works at: https://scholarship.law.columbia.edu/global_markets_corporate_ownership

Part of the Business Organizations Law Commons

Recommended Citation

Ira M. Millstein Center for Global Markets and Corporate Ownership, *Proxy Access 2.0: A Recap on 1.0 and the Economic Analysis*, (2016).
Available at: https://scholarship.law.columbia.edu/global_markets_corporate_ownership/24

This Paper is brought to you for free and open access by the Research Centers & Programs at Scholarship Archive. It has been accepted for inclusion in Ira M. Millstein Center for Global Markets and Corporate Ownership by an authorized administrator of Scholarship Archive. For more information, please contact scholarshiparchive@law.columbia.edu.

Columbia Law School

Millstein Center for Global Markets
and Corporate Ownership

session brief no. 6

Proxy Access 2.0

A Recap on 1.0 and the Economic Analysis

© 2016, Millstein Center for Global Markets and Corporate Ownership, Columbia Law School

About the Millstein Center for Global Markets and Corporate Ownership

Building on Columbia Law School's longstanding strength in corporate and securities law, the mission of the Millstein Center for Global Markets and Corporate Ownership is to bring world class scholarship, research and academic rigor to the vital task of restoring and strengthening long-term financing of innovative and durable public corporations, which are the underpinning of economic growth.

This mission is essential given today's capital markets which are global, complex and volatile, and bring consequences and uncertainties to those who rely on them: companies, investors, and ultimately the wider economy.

The Center's research on the capital market and its impact on corporate governance and performance builds upon the work of the earlier successful "Institutional Investor Project" at Columbia University (1986-94), as well as the successes of the Millstein Center for Corporate Governance and Performance at the Yale School of Management (2005-12). The value of the Center's research is enhanced through active engagement with practitioners.

This paper provides a brief summary of discussion points, presentations, and findings from the "Proxy Access 2.0" Conference held in April 2015.

The Center's Session Briefings are framed as concise summaries of events or reports designed to promote policy discussion or further research. They strive to encompass a diversity of perspectives and are based on a combination of presentations, independent research, and the experiences of market leaders and thought leaders who participate in Center events or workshops. Participants generally include corporate board members and managers, institutional investors, advisors, leading academics, regulators, and other thought leaders.

Marcel Bucsescu, Executive Director of the Millstein Center served as lead editor. Jonathan Kim, former Senior Vice President, General Counsel and Secretary of Montpelier Re Holdings Ltd., and Rosemary Dodemaide, Operations Coordinator of the Millstein Center, served as secondary editors. Allison Mitkowski of Little Foot Communications served as the reporter.

The Millstein Center is extraordinarily grateful to all of its sponsors and partners, which provide support on an ongoing basis (a list of supporters can be found on the Center's website).

We would also like to extend a special Thank You to the CFA Institute and Deloitte for their collaboration, contributions, and participation in this event.

Views or positions presented in this briefing do not necessarily reflect the position of the Center, the Law School, University, or any supporters or particular participants.

On April 27, 2015, the Ira M. Millstein Center for Global Markets and Corporate Ownership and the CFA Institute hosted a discussion on the state of proxy access. The following is a summary of the panel discussion.

"Proxy access", or the rules governing the ability of shareholders to make nominations to fill vacancies on the boards of publicly listed companies, has been on the agenda and the minds of shareholder rights proponents for decades. Some observers view proxy access as a simple mechanism to improve the process of selecting corporate directors in the U.S. Others favor "majority voting", or director elections where shareholders vote for each director-nominee separately, as an alternative to proxy access.[1] The nuances of proxy access and majority voting were examined during a panel discussion hosted by the Ira M. Millstein Center for Global Markets and Corporate Ownership and the CFA Institute. Using the CFA's recent report on the subject as a foundation for the discussion,[2] the panel delved into various viewpoints on how to best serve the interest of shareholders in a balanced and responsible manner.

Setting the Stage

The author of the report framed the debate for the panel in simple terms: how easy it is for a shareholder to put nominees for the board on the ballot versus the traditional construct, whereby nominations are made not by shareholders but by the board itself, often with the input of management? He noted that reaching a conclusion about proxy access is no simple task. While proponents argue that proxy access affords greater levels of accountability to shareholders in the board selection process, others raise concerns about the impact of increased shareholder input in the process on board dynamics and functionality. Nowadays, there are more stringent corporate governance practices and sensibilities in place amongst boards, along with a higher level of scrutiny by shareholders and third parties such as proxy advisory firms. The dynamic, it was observed, has shifted in favor of shareholders over the last decade in particular. As a result, nominating committees, boards and directors are more inclined now than they were in the past to act independently but with the understanding that they will be held accountable for their actions.

One panelist commented that the determinations gleaned from the report's research seemed rather inconclusive, which he said made it difficult to accept the report's assertions regarding the benefits of proxy access. Another issue with the study is that it focused on the benefits of proxy access, but not on the costs. Thus, the panelist felt that the report contained the same flaws as the SEC's rulemaking on the issue.

A Necessary Balancing Act

Refocusing the debate, the suggestion was made that the issue of proxy access, at its core, relates to the tension between allocating control over the board nomination process to shareholders and the board of directors. There are several mechanisms for holding management accountable, he said, and each mechanism carries a different level of risk. While proxy access also holds management accountable, it potentially carries a high risk of error in the sense that placement of an ineffective director could have material impact on the company. So the issue at stake is how to balance accountability with authority?

It is often heard in corporate governance circles that a one-size-fits-all model doesn't work. And the same goes for proxy access, opined the first speaker. The public company model in the U.S. allows for shareholders and boards to determine the governing systems of corporations. This structure has led to a diversity of such systems. At the same time, the public company model is currently at a disadvantage after years of burdensome new rules and regulations. Major companies such as Facebook are raising funds abroad to avoid the U.S. regulatory regime. This trend should be a warning sign, the panelist noted, adding that when Michael Dell says he will never again operate another public company in the U.S., it means the U.S. public company model has a serious problem. *"While we're here debating proxy access, investors are also making decisions that are going against the public company model,"* he said.

Another panelist representing a large institutional investor emphasized that there should be checks and balances to ensure that companies are operating in the best interest of shareholders. He said his firm believes that proxy access is a basic shareholder right, equal to majority voting as the top two accountability mechanisms. In the panelist's view, shareholders should be provided with a mechanism that is conducive to using proxy access without being overly restrictive or onerous. However, he clarified that he was not advocating proxy access in the context of shareholder democracy, as nominating committees are better-positioned to identify the best candidates for boards on an ongoing basis and over time. Proxy access, he said, is more of a "safety valve" for shareholders to intervene with alternative candidates in the event of a material failure within a company.

---

[1] With majority voting, shareholders are granted one vote for each share held in relation to each director-nominee. The holder of 100 shares would thus have the right to cast 100 votes for each nominee on a proxy ballot. By contrast, "cumulative voting" grants shareholders one vote per share multiplied by the number of director-nominees. Cumulative voting allows shareholders to apply all votes to one candidate or to divide them up amongst candidates. If a shareholder owns a single share and there are three empty seats on the board, the shareholder has three votes.

[2] The CFA Institute, *Proxy Access in the United States: Revisiting the Proposed SEC Rule* (New York, 2014).

A panelist representing a large metropolitan pension fund commented that proxy access has been a priority for institutional investors since at least 2003. That year the SEC first proposed a rule in response to the failures of Enron and WorldCom—each attributable in part to poor corporate governance and board oversight. The panelist said the most effective way to enact proxy access in the U.S. is for the SEC to reissue its universal rule that was rejected by the United States Court of Appeals for the District of Columbia 2011. The rule established a three percent ownership stake for three years as a ceiling for certain shareholders to request the inclusion of their director-nominees in a company's proxy materials.[3] A separate rule also provided investors with "private ordering" which would enable shareholders to lower the threshold for proxy access but not increase the ceiling.[4] The panelist said his organization would continue to advocate for the universal rule. However, there is tremendous momentum in the world of private ordering, and he is hoping to see the widespread adoption of proxy access by either method in the future.

Or a Solution in Search of a Problem?

Toward the end of the panel discussion, one panelist posed a question that changed the tone of the conversation. She asked whether or not proxy access is even appropriate, adding that she felt the industry still does not have a read on the problem—assuming there's a problem to begin with. Some observers have said proxy access is needed in the event of a zombie director or an "accidental" (i.e. unelected) director. However, it was pointed out that the number of unelected directors is estimated at no more than 18 out of 98,000 (.018%) in the past five years. In a pure majority vote situation, only 18 directors have actually lost their seats, she noted. And of those 18, nearly two-thirds (11) left within the first year. The panelist said proxy access would be warranted for the companies with the unelected directors who did not vacate their positions after the vote. Essentially, however, this is a solution in search of a problem, or so the argument goes.

Additionally, the panelist noted that with proxy access, the board is typically viewed through a proponent's lens as an inadvertent collection of individuals rather than a deliberate mix of skills and qualifications that are best suited to oversee the affairs of a corporation. With proxy access, a company runs the risk of losing a financial expert or diverse candidate whose skillset is conducive, or even necessary, to promoting the success of the board as a whole. Changing directors every year, a potential pitfall in the minds of some proxy access opponents, also has the potential to disrupt progress, as new board members would have to become acclimated to the current state of the company and help guide the decision-making process for the present and future states. Proxy access is not right for all companies and not all shareholders are in favor of proxy access. As such, the panelist said her organization's stance is that proxy access should be implemented on a case-by-case basis.

Proxy Access as a Backstop to Majority Voting

A panelist representing a trade union commented that making the corporate governance system truly accountable requires steps beyond preserving the democratic minimum of equal voting rights. Shareholders, he said, should have an equal ability to nominate directors, and all eligible candidates should have equal access to the proxy statement in order to present their statement of candidacy.

He noted that his organization went on record in favor of proxy access in the mid-1980s, and later tried to balance proxy access with a proposal to hold elections every three years while enhancing voting rights every five years. The idea behind this move was to create a corporate governing system that brought long-term perspective to the board while providing shareholders with the right to proxy access during elections. Through the preparation of a white paper on shareholder management, however, the panelist said he and his colleagues began to realize that the push for majority voting was the better reform at the time.

The panelist went on to say that while his organization was an early proponent of proxy access, they did not view the concept as a middle ground. Rather, they felt the best formulation of proxy access was to make it trigger based on a failed candidacy of a director or a set of directors. For example, if a director fails to receive majority support in a majority voting context, yet refuses to resign from the board, it should trigger the access right, enabling shareholders to put forth an alternative director. In this way, proxy access serves as a backstop to

---

[3] Dodd-Frank authorized the SEC to promulgate "proxy access" rules, allowing specified shareholders the ability to include director-nominees in a company's proxy materials. Ultimately, the SEC issued final rules facilitating shareholder director nominations which were successfully challenged by the Business Roundtable and the Chamber of Commerce of the United States of America in the D.C. Circuit Court of Appeals. As adopted, Rule 14a-11 would have provided qualifying shareholders or groups holding at least three percent of the voting power of a company's securities who have held their shares for at least three years with the ability to request that public companies include the shareholders' director-nominees in their proxy materials.

[4] Under Rule 14a-8(i)(8), which was not the subject of the litigation over Rule 14a-11, a shareholder can propose changes to the company's governing documents specifying procedures by which shareholders may include director nominees in the company's proxy materials (however proposals to include specific nominees may still be excluded under Rule 14a-8(i)(8)(iv)). If proxy access procedures are adopted, a shareholder can then require specific director nominees to be included in the company's proxy materials pursuant to the company's amended proxy access regime. In other words, companies may not exclude from their proxy materials shareholder proposals for less restrictive proxy access procedures.

majority voting. *"It's an orderly, systematic growing process that gets you to smart voting,"* the panelist explained, adding that it was nearly impossible to un-elect a director without a proxy contest as recent as five years ago.

And an Opportunity to Meet Halfway With Shareholders

A panelist representing a large corporation called his company's decision to implement proxy access "pragmatic" because it engaged shareholders in a thoughtful, forward-thinking way. While the initial impetus for engaging on the topic was a shareholder proposal, the decision to implement proxy access came out of productive conversations with shareholders. The board and management discussed details such as thresholds and ownership tenure with multiple shareholders, and determined there was substantial interest in proxy access. After the board embraced the concept, it gave the company an opportunity to implement a number of safeguards that might have been unattainable had the company not taken such a proactive approach. The company's bylaws are now equal and balanced as between the board and shareholders, with ownership requirements for proxy access by the latter that are not overly restrictive. Simply put, the company met shareholders halfway on the issue before the possibility of a control contest went from an idea to reality.

Asked whether the company was concerned that an activist might use proxy access to front run a proxy fight, the panelist noted that they were not concerned for several reasons. First, the company would know through SEC filings and shareholder monitoring if an activist was trying to amass a significant enough stake well before the thresholds were met. As for the notion that an activist might partner with a long-term shareholder, the company's board and management assumes that if they are doing their jobs correctly and engaging with their key shareholders, they will know of any dissatisfaction on the part of investors before an activist can make a play.

Conclusions

Overall, the key theme that came out of the session was that proxy access is still in its nascent stages of adoption but is clearly gaining momentum. Moreover, there is still a robust and ongoing debate on the details. Holding size and period, group size, and myriad other variables may well allow for the principle of proxy access to be adopted as a governance standard, while also allowing companies and investors to tailor the structure to each unique circumstance. Clearly, themes of director accountability to investors and access to the boardroom are core issues for the shareholder community. And as investor engagement grows, issues like proxy access may well become more prevalent, but also less relied upon by shareholders.

COLUMBIA LAW SCHOOL

MILLSTEIN CENTER FOR GLOBAL MARKETS
AND CORPORATE OWNERSHIP

435 West 116th Street, Room 536
New York, NY 10027

Phone: 212-854-3119 | Fax: 212-854-2368

millsteincenter@law.columbia.edu

WWW.LAW.COLUMBIA.EDU/MILLSTEINCENTER