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# GOVERNANCE PERSPECTIVES

## Observations on the 2016 Proxy Season

- The proxy access movement hit its stride in 2016—more than 36 percent of S&P 500 companies have adopted proxy access bylaws.
- Although this wave of bylaw adoptions occurred almost five years after the demise of the SEC's proxy access rules, most of the bylaws were adopted since the NYC pension funds launched their campaign on the topic in late 2014.
- Other shareholder proposals submitted for the 2016 proxy season focused on familiar governance subjects, although the number of proposals on "high stakes" governance topics has dropped precipitously in recent years as key takeover defenses—like classified board terms—have largely been dismantled.

The 2016 proxy season has drawn to a close. The key topic of the 2016 season was proxy access, with roughly 200 shareholder proposals submitted on that topic, almost twice the number submitted last year. Seventy-two of the 2016 proposals were sponsored by the NYC pension funds' Boardroom Accountability Project, the first dedicated proxy access campaign led by institutional investors. The funds sponsored 75 proxy access proposals in 2015, and given the success of that inaugural campaign, it was not surprising that perennial retail activist John Chevedden and other individual shareholders took an interest in proxy access in 2016, sponsoring more than 100 proposals.

Companies' responses to proxy access proposals differed significantly between the 2015 and 2016 proxy seasons. In 2015, nearly all of the companies that received proxy access proposals submitted them to shareholder votes. In 2016, companies generally took a very different—and more proactive—approach, taking board action to implement a proxy access bylaw, thus bypassing the shareholder vote altogether.

This large-scale adoption of proxy access bylaws was a significant turning of the tide in company responses to these proposals, and also manifests the power of institutional shareholders in shaping today's corporate governance paradigm. A few observations follow:

- **For better or worse, absent unusual circumstances like substantial founder ownership, the 3 percent/three-year ownership thresholds are now standard for proxy access.** There may still be some wiggle room at the margins, including the cap on the number of shareholders in the

nominating group, but it is difficult to imagine many scenarios where that cap would make or break a nomination.

- By now, the "3 percent/three-year" formulation for proxy access has become so familiar that the significance of the holding period is largely overlooked. **A three-year ownership requirement for each member of a nominating group is a huge win for corporate America.** A three-year holding period inhibits short-term opportunists who seek to take advantage of proxy access provisions, while permitting nominations from shareholders who have demonstrated a long-term commitment to, and interest in, the company.

- **The implementation of proxy access via "private ordering" took less than two years to gain significant traction among large U.S. public companies.** When the SEC's universal proxy rules were overturned by the courts in 2011, some commentators expressed skepticism that mainstream U.S. public companies would ever willingly adopt proxy access through "private ordering." Yet more than 36 percent of S&P 500 companies have now done so. Although half a decade has passed since the fall of the SEC's proxy access rules, five years is not a terribly long time in terms of governance trends, especially in light of the decades it took for the SEC to enact proxy access rules in the first place. Further, nearly all of the companies that have adopted proxy access bylaws did so after the NYC pension funds launched their Boardroom Accountability Project in November 2014, only 19 months ago. From that standpoint, proxy access can be seen as a significant governance change that has been adopted by a sizeable percentage of S&P 500 boards within a relatively short timeframe, prompted almost exclusively by the efforts of a single institutional fund group.

  Of course, we will have to wait for the 2017 proxy season and those that follow to see whether and how investors will use these proxy access bylaws as to date, no proxy access mechanisms have actually been invoked. Our view is that it is unlikely that shareholders will actually utilize the proxy access avenue, but that its existence will greatly increase shareholder leverage, including by activists, and may well accelerate the reshaping of traditional approaches to shareholder engagement.

- **The reaction of many in corporate America to the concept of proxy access has cooled considerably since 2010.** Of course, we cannot pinpoint why the companies that adopted a proxy access bylaw in response to a 2016 shareholder proposal chose to do so, but the trend is consistent with others, including the increasing number of companies that decide to negotiate rather than to fight with activists and other shareholders, including in respect of the fundamental notion of board composition.

- While we recognize the necessity of a pragmatic approach to shareholder initiatives, **we find it unfortunate that the specter of possible consequences of proxy advisor voting policies—which are real, immediate, and lasting—may weigh more heavily than they should on board decisions relating to a fundamental issue of corporate governance**—the process for nominating corporate directors. Moreover, we are concerned that the proxy access experience will fuel other intrusive measures championed by purported shareholder-rights activists such as director term limits and say-on-director pay, at least at companies that do not have substantial founder ownership.

Although proxy access proposals drew the most attention in the 2016 proxy season, shareholders did submit proposals on other governance topics. By the numbers, proposals addressing political and lobbying activities, climate change, and independent board leadership were some of the most frequent, despite the typically low shareholder support for those topics. Other proposals that were once submitted in large numbers are relatively rare today, although shareholder support levels for the topics remain high, including the following:

- Proposals to declassify boards (eight proposals submitted; 81 percent average support of votes cast);
- Proposals to eliminate supermajority requirements (15 proposals; 60 percent);
- Proposals to permit shareholder-called special meetings (18 proposals; 42 percent); and
- Proposals to permit shareholders to act by written consents (17 proposals; 41 percent).

Shareholder proposals on these topics are typically nonbinding in nature and historically were treated as such—it was not

uncommon for shareholders to approve proposals on these topics year after year without responsive board action. Today, the environment for shareholder proposals is markedly different. As noted above, shareholder-supported proposals are now enforced by proxy advisor voting policies, which makes the "precatory" nature of these proposals largely a misnomer. As the 2016 proxy season demonstrates, with that enforcement mechanism in place, institution-backed support for a governance initiative can have a considerable impact on the practices of even the largest U.S. public companies.

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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