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Proxy Access 2016: Market Trends and Shareholder Proposal Developments

Analysis of Terms Adopted Since August 1, 2015 and Key Elements of Shareholder Proposals for the 2016 Proxy Season

As companies prepare for the 2016 proxy season, the number of adopted proxy access bylaws has almost doubled in recent months and at least two new forms of proxy access shareholder proposals have appeared. On the company side, proxy access bylaws adopted since August 1, 2015 confirm the market trend toward a 3% ownership threshold, 3-year holding period, 20% nomination limit and 20-member group limit. Trends for ancillary provisions also have coalesced to a significant extent. On the shareholder-proponent side, James McRitchie, a frequent filer of shareholder proposals and advocate for the proxy access movement, has published two new forms of proxy access shareholder proposals. One of them targets the elimination of provisions in existing proxy access bylaws that have been opposed by the Council of Institutional Investors ("CII"), and the other builds on the standard proposal seeking proxy access by limiting ancillary features that are commonly included in adopted proxy access bylaws. Proxy access-related developments during the 2015 proxy season are discussed in detail in our publication Proxy Access Bylaw Developments and Trends, which we distributed on August 18, 2015.

A. TRENDS IN KEY PROXY ACCESS TERMS SINCE AUGUST 1, 2015

39 proxy access bylaws have been adopted between August 1, 2015 and November 9, 2015. 15 of these were adopted by companies in response to losing a shareholder vote on the NYC Comptroller shareholder proposal that was prevalent in the 2015 proxy season. As a result, as of November 9, 2015, the total number of adopted proxy access bylaws stands at 80. The following summary highlights trends in certain key terms of the proxy access bylaws adopted after August 1st:

1. **Ownership threshold.** 95% of proxy access bylaws adopted since August 1st have a 3% ownership threshold. 3% is consistent with the NYC Comptroller shareholder proposal, the position of CII and the requirements of vacated SEC Rule 14a-11. In addition, 3 companies (CF Industries, Marathon Oil, Priceline) that adopted a proxy access bylaw with a 5% threshold before losing a shareholder vote on the NYC Comptroller shareholder proposal have since amended their bylaws to establish a 3% threshold. Only 2 companies, both of which defeated the NYC Comptroller shareholder proposal, have adopted a 5% ownership threshold since August 1st.

2. **Holding period.** All bylaws adopted since August 1st require a 3-year holding period, which is consistent with the position of the NYC Comptroller, CII and vacated Rule 14a-11.

3. **Maximum number of nominees.** 95% of bylaws adopted since August 1st provide some form of 20% maximum on the percentage of the existing board that can be represented by proxy access nominees. 36% of bylaws adopted since August 1st provide for a flat maximum of 20% (rounded down) of the existing board, but an increasing number (54%) now follow a "the greater of 20% and two directors" maximum, in line with CII's opposition to a limitation that would prevent shareholders from nominating at least two candidates. In addition, 2 bylaws (5%) have a "the greater of 20% and one director" maximum. Notwithstanding that the NYC Comptroller's proposal and Rule 14a-11 provided for a 25% maximum, only 5% of bylaws adopted since August 1st have a 25% maximum. Among the 15 companies that lost a vote on the NYC Comptroller's shareholder proposal in the 2015 proxy season and adopted a proxy access bylaw after August 1st, 14 adopted either 20% or "the greater of 20% and two." In the results of its annual policy survey published September 28, 2015 (the "ISS Survey"),[1] ISS noted that a large majority of investors would consider a maximum set at *less* than 20% as non-responsive to a successful shareholder proposal and potentially warrant votes against the election of directors at such companies.

4. **Formation of shareholder groups to reach the ownership threshold and treatment of funds.** 95% of post-August 1st bylaws also permit groups of up to 20 eligible shareholders to meet the ownership thresholds. The remaining 5% (none of which were adopted in response to a lost shareholder vote on the NYC Comptroller proposal) limit group size to 15 shareholders. No post-August 1st bylaw permits an unlimited number of group members. The large majority (87%) provides that two or more funds that meet certain criteria (most commonly, being under common management and investment control) constitute one person. The ISS Survey notes that a large majority of investors would consider an aggregation limit of less than 20 adopted after a successful shareholder proposal as non-responsive.

5. **Treatment of incumbent proxy access directors and repeat nominator eligibility restrictions.** 77% of post-August 1st bylaws provide that incumbent directors who were proxy access nominees and who are being renominated by the board will continue to count against the maximum number of permitted proxy access nominees for at least 2 years after their election. Of these, 40% were adopted after the company lost a vote on the NYC Comptroller proposal and about one-third provide for a period of 3 years while 1 does not specify any particular time limitation. 10% of bylaws adopted after August 1st also restrict a shareholder from nominating further nominees for a period of at least 2 years (1 company has adopted a 3-year period) if the shareholder has a prior successful access nominee serving on the board.

6. **Repeat nominee eligibility restrictions.** 69% of post-August 1st bylaws contain an exclusion of candidates who received less than a specified threshold of support (almost universally at 25%) of votes cast in a previous annual meeting for a period of up to two years;

[1] The results of the 2016 ISS annual global voting policy survey can be accessed at: https://www.issgovernance.com/iss-releases-results-of-annual-global-voting-policy-survey/.

19% of these were adopted in response to a lost shareholder vote on the NYC Comptroller proposal. CII opposes restrictions on renominations as a result of receiving a prior low vote, and the ISS Survey likewise indicates that the inclusion of this feature after a successful shareholder vote would likely be considered "nonresponsive" by a large majority of investors.

7. **Treatment of Loaned Shares.** In line with the position taken by CII, 90% of post-August 1st bylaws provide that loaned shares will be considered continuously owned if the nominating stockholder has the right to recall the loaned shares and does so either as of the date of the nomination notice, upon notification that its nominees would be included in the proxy statement or in time to vote the securities at the annual meeting.

8. **Compensation Arrangements.** Similarly, in line with CII's view, the large majority (92%) of bylaws adopted after August 1st permit nominees to have compensation arrangements with third parties for serving as a director of the company but require that such compensation arrangements be fully disclosed.

B. PROPOSAL AT WHOLE FOODS

Effective June 26, 2015, the board of directors of Whole Foods Market, Inc. ("Whole Foods") adopted a 3%, 3-year, 20% maximum and 20-member group proxy access bylaw. The Whole Foods bylaw also requires loaned shares to have been recalled as of the date of the nomination notice in order to count towards the ownership requirement, that compensatory arrangements between the nominee and a party other than Whole Foods in connection with service as a director provide a ground for exclusion, and that a nominee who has received less than 25% of the votes cast in a previous annual meeting is ineligible for renomination at the next two annual meetings. On September 24, 2015, James McRitchie published that he had submitted a shareholder proposal to Whole Foods for consideration at the next annual meeting that would ask the Whole Foods board to enact the following changes (most of which would be in line with the positions supported by CII) to its existing proxy access bylaw:[2]

- increase the maximum number of nominees to "the greater of 25% and two directors;"
- require loaned shares to be recallable and to have been recalled as of the date of the meeting only;[3]
- remove the cap on the number of shareholders that are permitted to aggregate their shares to achieve the minimum ownership requirement;
- remove the prohibition on third party compensation arrangements, provided that any such arrangements are disclosed to Whole Foods;
- remove the limitation on renominations of nominees based on the number of votes received in a previous election; and
- generally, defer decisions about the suitability of shareholder nominees to the vote of shareholders.[4]

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[2] The text of the Whole Foods Proposal is available at: http://www.corpgov.net/2015/09/fixing-proxy-access-lite/.

[3] CII's position on this point, which is included in its list of "Best Practices" available at http://www.cii.org/proxy_access, is that the holder must represent that it has the legal right to recall the loaned shares for voting purposes and will vote the shares at the shareholder meeting. In practice, this means that the loaned shares will need to have been recalled by the *record date* in order to be voted at the meeting; recalling the shares only by the *meeting date* will not normally allow the holder to vote the shares at the meeting.

[4] This last point is not included in CII's list of "Best Practices," and its specific meaning and scope appear unclear.

C. NEW TEMPLATE PROPOSAL

On September 30, 2015, Mr. McRitchie published a new template proxy access shareholder proposal that seeks to confine any ancillary limitations/restrictions (other than the key minimum ownership/minimum holding period/maximum number of nominees) imposed on proxy access shareholder nominations to limitations/restrictions that are equally applicable to nominees of the board. As a result, this new template proposal has the potential to be more limiting than the NYC Comptroller shareholder proposal. Specifically, the new template proposal contains the following terms:[5]

- a minimum ownership requirement of 3% (including recallable loaned stock) continuously for at least 3 years;
- no limit on the number of shareholders that may aggregate their holdings to satisfy the minimum ownership requirement;
- a maximum number of nominees of "the greater of 25% and two directors;"
- the provision by the nominating stockholder of information about the nominee and the nominating stockholder required by the company's bylaws and the rules of the SEC, as well as proof of ownership of the required shares;
- a customary covenant of the nominating stockholder to assume liability resulting from the nominating stockholder's communications with shareholders and to comply with applicable solicitation rules;
- a representation that the required shares were acquired in the ordinary course of business and not with a view to influencing or changing control; and
- the bylaws must not contain any additional restrictions on nominations or renominations of proxy access nominees that would not also apply to other nominees of the board.

We understand that John Chevedden, the most prolific filer of shareholder proposals, has begun submitting shareholder proposals based on this template.

D. POSSIBLE COMPANY RESPONSES TO RECEIPT OF A SHAREHOLDER PROPOSAL

Companies can employ a variety of strategies in response to a shareholder proxy access proposal. To assist companies in evaluating the appropriate strategy, we outline below several possible approaches to a "standard" shareholder proposal and Mr. McRitchie's new template proposal.[6]

If the company receives a shareholder proposal on terms similar to the 2015 proposal of the NYC Comptroller:

- ***Preemptive Adoption and Seek Exclusion for Substantial Implementation.*** The company could adopt its own proxy access bylaw prior to the annual meeting and apply for no-action relief from the SEC under Rule 14a-8(i)(10) to exclude the shareholder proposal on the basis of substantial implementation, following General Electric's example in the 2015 proxy season.[7]

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[5] The text of the New Template Proposal is available at: http://www.corpgov.net/2015/09/avoiding-proxy-access-lite-revised-template/.

[6] In our experience, it is rarely a promising strategy to negotiate with the proponent, although the feasibility of that approach will need to be evaluated on a case-by-case basis.

[7] The General Electric no-action letter and related correspondence are available at: http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/kevinmaharrecon030315-14a8.pdf. To

- ***Competing Company Proposal.*** The company could allow the shareholder proposal to come to a vote while also offering its own management-sponsored proposal. In the past, this response (with shareholder and management proposals often varying on key terms) has seemingly had mixed results, with the company proposal passing approximately half of the time. These results, however, may not carry much predictive value for bylaws with a 3% ownership requirement because almost all competing company proposals had a 5% ownership requirement, which undoubtedly affected the vote. Usually, a company proposal would be non-binding and cover the same provisions as the competing shareholder proposal, which appears to be a superior approach to putting the full bylaw up for a vote. Presenting a detailed bylaw could engender a negative reaction from some shareholders in contrast to the simpler shareholder proposal and, should the company proposal lose, it would be very difficult for the company to determine exactly which provisions shareholders were voting against. Moreover, boards may be more reluctant to make unilateral subsequent changes to a shareholder-approved bylaw.
- ***No Company Action Until After Meeting.*** The company could simply let the shareholder proposal come to a vote, suggest that shareholders vote against it or take no position on the proposal, and, if the shareholder proposal passes, implement proxy access after the meeting. The ISS Survey results on responsiveness suggest that the bylaws that are currently being adopted by companies should be viewed as responsive and reflect an acceptable approach for companies and institutional shareholders alike.

If the company receives a "no additional restrictions" shareholder proposal that follows the McRitchie template, it is not clear whether the SEC will continue to permit exclusion under Rule 14a-8(i)(10), especially after its recent change to the standard for determining the ability of companies to exclude shareholder proposals as "directly conflicting" under Rule 14a-8(i)(9).[8] To the extent shareholder proposals based on the McRitchie template are approved by shareholders, it remains to be seen how ISS (or shareholders) would respond to the implementation of less than all of the changes sought by that template.

More generally, the advisability of proactively adopting a proxy access provision, including before receipt of a shareholder proposal, continues to vary from company to company. We note that the proposal at Whole Foods suggests that even fairly common bylaws may be subject to a second round of proposals to remove certain features.

Please contact any of the lawyers listed at the end of this memo or your contact person at the firm if you wish to discuss any of these matters.

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date, this is the only SEC no-action letter addressing the ability to exclude a shareholder proxy access proposal as substantially implemented.

[8] See our publication SEC Staff Issues Guidance on Excluding Shareholder Proposals, which we distributed on October 23, 2015.

ABOUT SULLIVAN & CROMWELL LLP

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