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PROXY ACCESS: SHAREHOLDER DEMOCRACY OR CREEPING MERCANTILISM?

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EXECUTIVE SUMMARY

Following certain rule changes made by Congress and the U.S. Securities and Exchange Commission, the 2015 proxy season has seen a deluge of shareholder proposals at U.S. public companies calling for proxy access – the ability of minority shareholders to have their slate of directors included in the materials presented to shareholders ahead of a company's annual meeting. Promoted as a means to enhance "shareholder democracy," the legal and economic literature on proxy access does not support claims it maximizes shareholder wealth. Moreover, the process may allow unions and certain elected officials to use the corporate boardroom to effect politically motivated outcomes. This paper's analysis of 65 proxy ballots completed through June 2015 suggests shareholders of firms that passed access initiatives lost $14.6 billion of wealth. The paper concludes with recommendations to grant more leeway to companies that omit or disqualify some kinds of proxy access proposals, as well as changes to rein in the power of elected officials who serve as administrators of public pension plans.

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INTRODUCTION

In his 1776 master work, "An Inquiry into the Nature and Causes of the Wealth of Nations," Adam Smith expressed skepticism about the emerging business firm type that we know today as the public corporation. These new "joint stock companies," chartered by the crown and granted certain monopoly privileges, were particularly active in Britain's new overseas colonies. But what really concerned the godfather of all economists was their form of governance, ruled by directors who "seldom pretend to understand anything of the business of the company."

> The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.[1]

Smith's skepticism may indeed have been appropriate for the chartered joint stock companies of his time, which were more properly characterized as privatized instruments of the British state than they were examples of the free market. But since at least the mid-19th century, the public corporation – with its ability to tap deep and liquid markets, while limiting investors' liability solely to the size of their investments – has

1. Adam Smith, *The Wealth of Nations*, Book V, Chapter 1, Part III, 1776. http://econlib.org/library/Smith/smWN20.html

worked out pretty well, on balance, playing a crucial role in the exponential economic growth the world has seen since Smith's day.

To be sure, the evolution of accounting and reporting standards, not to mention a free and informed press, have been essential features of this success here in the United States. But so, too, has been the proxy statement. Issued by each U.S. public company in advance of its annual meeting, the proxy statement is the primary means by which companies communicate important information about the firm's performance and planned future direction to shareholders. It also must, by law, include various questions that shareholders are to settle through binding or advisory ballot elections. These typically include questions about board and executive compensation, as well as the selection of directors who will exercise appropriate oversight of a company's management, bound by strict fiduciary duties.

When it comes to governance, to paraphrase Alexander Hamilton, corporations are more like republics than true democracies. Under both state laws that govern corporate bylaws and federal regulations promulgated by the Securities and Exchange Commission, companies historically have been allowed to determine which director nominees will appear in proxy materials sent to shareholders. Effectively, control of the proxy slate has remained the exclusive purview of the existing board and its nominating committee. Independent shareholders can and have mounted election campaigns, but doing so is a costly process that requires soliciting both shareholders' attention and their votes. Because of their expense and the likelihood of failure, independent proxy solicitation initiatives typically have been limited to cases where a slate mounts a full-blown battle for control, such as those launched by hostile shareholders who in the 1980s were known as the "corporate raiders" – investors like Carl Icahn, Ron Perelman and Henry Kravis.[2]

Recent changes in the rules governing access to public companies' proxy ballots make it easier for so-called "activist" investors to nominate their own director candidates. Congress and the SEC thus far have been sanguine about the future of this so-called "shareholder democracy," positing that it will further maximize shareholder value and enhance corporate accountability. The existing academic literature does not support that view. Moreover, the process provides clear incentives for elected officials – serving in their capacity as administrators of large public employee pension funds – to use the corporate boardroom to effect politically motivated outcomes. Indeed, the recent rule changes could reintroduce exactly the sorts of concerns Smith raised two and a half centuries ago – cronyism practiced by unaccountable directors who shirk their fiduciary responsibilities to extract benefits for their own chosen factions.

The issue is coming to a head in the current proxy season, the period from roughly March through July when public companies tend to schedule their annual shareholder meetings. According to proxy adviser Glass Lewis & Co., an unprecedented 108 proxy access proposals were filed with public companies this year.[3] Of these, 75 come as a result of an activist initiative by New York City Comptroller Scott Stringer, acting as administrator of the city's $160 billion public employees' pension funds.

With results from most of these scheduled votes now available, our early analysis is that, rather than enhancing shareholder value, successful adoption of proxy access already has resulted in $14.6 billion in foregone shareholder value in this proxy season alone. This paper offers a summary of recent developments and examines some potentially troubling implications for the future of independent corporate governance.

DODD-FRANK AND PROXY ACCESS

Before Congress' passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in June 2010, neither state nor federal law provided a guaranteed avenue for so-called "activist shareholders" – generally defined as those who seek to use their equity positions in public companies to bring about some form of social change,[4] although the term often is applied to any active and vocal minority shareholder – to require that biographies and ballots for independently nominated director candidates be included in the proxy materials mailed to shareholders ahead of annual meetings.

There had been attempts by the Securities and Exchange Commission to promulgate proxy access rules before Dodd-Frank,[5] but these were greeted with significant resistance from public companies, who questioned whether the SEC had authority to demand the change. With Section 971 of the Dodd-Frank Act, Congress explicitly amended the Securities Exchange Act of 1934 to grant the SEC authority to issue:

> (A) a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer; and

2. David Futrelle, "Corporate Raiders Beware: A Short History of the 'Poison Pill' Takeover Defense," *Time*, Nov. 7, 2012. http://business.time.com/2012/11/07/corporate-raiders-beware-a-short-history-of-the-poison-pill-takeover-defense/

3. Bob McCormick, "Glass Lewis' Views on Proxy Access Developments," Glass Lewis & Co., Jan. 28, 2015. http://www.glasslewis.com/blog/glass-lewis-views-proxy-access-developments/

4. Investopedia, "Shareholder Activist," accessed July 2, 2015. http://www.investopedia.com/terms/s/shareholderactivist.asp

5. Securities and Exchange Commission, "Facilitating Shareholder Director Nominations," Release No. 33-9086, July 10, 2009. http://www.friedfrank.com/siteFiles/Publications/388037AB789F3BD549FF39C08BF4F24B.pdf

> (B) a requirement that an issuer follow a certain procedure in relation to a solicitation described in subparagraph (A).[6]

Just weeks after President Barack Obama signed the law, the SEC would go on to adopt proxy access rules in a 3-2 vote at its Aug. 25, 2010 meeting. The rules were scheduled for an effective date of Nov. 15, 2010 for most companies, with a three-year delay for companies with market capitalizations of less than $75 million. During that period, the SEC was to study the impact of the rules on smaller companies.[7] Under the new Rule 14a-11, shareholders would be permitted to advertise the formation of groups interested in submitting director nominees by way of a new Schedule 14N filing.

Provided the shareholders or shareholder groups combined to hold at least a 3 percent stake for at least three years before the filing, and provided the filing was made between 120 and 150 days before the company's annual meeting, the company would be required to include information about the director nominees and a means for shareholders to vote for them in the annual proxy packets (although company management could include a recommendation that shareholders vote against the nominee in question).

The rules allowed a shareholder to submit nominations for up to a quarter of the board's seats, or at least one seat, whichever was greater. In cases where a company received nominations from more than one shareholder group, the rules stipulated that priority for inclusion in proxy materials would given to the one with the largest stake. They also required shareholders to attest that they would continue to hold the required 3 percent stake through, and beyond, the election process.

But many questions remained following the SEC's vote, including how the new Rule 14a-11 would interact with corporate bylaws, which continue to be regulated under state law (most notably, in Delaware). For instance, would a prospective nominating group of shareholders be required to comply with bylaw requirements about advance notice, or would the 14N process be sufficient? SEC Commissioner Troy Paredes cited this concern in joining Commissioner Kathleen Casey to vote against adoption of the rule:

> Rule 14a-11's immutability conflicts with state law. Rule 14a-11 is not limited to facilitating the ability of shareholders to exercise their state law rights, but instead confers upon shareholders a new substantive federal right that in many respects runs counter to what state corporate law otherwise provides.[8]

However, in a Sept. 20, 2010 speech before the Council of Institutional Investors in San Diego, Calif., SEC Commissioner Elisse Walter offered what many took to be a definitive statement that the rule did not vacate relevant state laws governing how shareholders may, and may not, nominate directors or make changes to a company's bylaws:

> As you know, access is only available when you have a right under state law to nominate directors. Many companies have requirements in their bylaws that are applicable to shareholders seeking to nominate a director. These apply to an access nomination or a traditional proxy contest nomination. For example, a bylaw may require that the D&O Questionnaire be submitted for each nominee. So, as a practice point, be sure to check for any of these requirements.[9]

In the early fall of 2010, references to Rule 14a-11 began to appear on the SEC's EDGAR public filing system. One notable case involved a September 2010 filing by activist hedge fund Discovery Equity Partners LP disclosing that it intended to use Rule 14a-11 to nominate two directors to the board of Tier Technologies Inc., in which it held a nearly 14 percent stake.[10] But the period of speculation about how Rule 14a-11 might play out didn't last long. Before it ever could take effect, it already was being challenged in court.

On Sept. 29, 2010, the U.S. Chamber of Commerce and the Business Roundtable filed a joint petition with the U.S. Court of Appeals for the District of Columbia Circuit to review their claims that the SEC's rule was "arbitrary and capricious"; that it violated the federal Administrative Procedure Act; and that the commission failed to uphold its statutory obligation (under both the Securities Exchange Act of 1934 and the Investment Company Act of 1940) to assess the rule's impact on "efficiency, competition and capital formation."[11] In their joint release announcing the petition, the Chamber and Roundtable charged the SEC had "erred in appraising the costs that proxy access would impose on American

6. Government Printing Office, Public Law 111-203, July 21, 2010. http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm

7. Securities and Exchange Commission, "Facilitating Shareholder Director Nominations," Release Nos. 33-9136; 34-62764, Aug. 25, 2010. http://www.sec.gov/rules/final/2010/33-9136.pdf

8. Troy A. Paredes, "Statement at Open Meeting to Adopt the Final Rule Regarding Facilitating Shareholder Director Nominations," Securities and Exchange Commission, Aug. 25, 2010. https://www.sec.gov/news/speech/2010/spch082510tap.htm

9. Elisse B. Walter, " Speech by SEC Commissioner: 'What's Next?': Remarks Before The 2010 Fall Meeting of the Council of Institutional Investors," Securities and Exchange Commission, Sept. 20, 2010. www.sec.gov/rules/final/2010/33-9136.pdf

10. Ted Allen, "Investor Plans to Use New Proxy Access Rule," RiskMetrics Corporate Governance Blog, Sept. 19, 2010. http://blog.riskmetrics.com/gov/2010/09/investor-plans-to-use-new-access-rule.html

11. Press release, "U.S. Chamber Joins Business Roundtable in Lawsuit Challenging Securities and Exchange Commission," U.S. Chamber of Commerce, Sept. 28, 2010. https://www.uschamber.com/press-release/us-chamber-joins-business-roundtable-lawsuit-challenging-securities-and-exchange

corporations, shareholders, and workers at a time our economy can least afford it." [12]

The SEC subsequently granted a motion to stay the rules, pending the outcome of the D.C. Circuit's review.[13] That would come in July 2011. In a 3-0 opinion by Judge Douglas Ginsburg, the court vacated the rule, agreeing with the Chamber and Roundtable that the commission had failed to follow proper administrative procedure in promulgating a rule just four weeks after Dodd-Frank was signed:

> We agree with the petitioners and hold the Commission acted arbitrarily and capriciously for having failed once again — as it did most recently in *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166, 167–68 (D.C. Cir. 2010), and before that in *Chamber of Commerce*, 412 F.3d at 136 — adequately to assess the economic effects of a new rule. Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters. For these and other reasons, its decision to apply the rule to investment companies was also arbitrary.

The circuit court's decision marked the end of one battle. But another was just over the horizon.

PROXY ACCESS, TAKE TWO

The SEC did not appeal the Ginsburg decision and has, as of this writing, yet to recommence proxy access rulemaking. It remains unclear whether it ever will. While Dodd-Frank grants the SEC authority to set minimum proxy access standards, it does not mandate that it do so.

However, at the same August 2010 meeting where it adopted Rule 14a-11, the SEC made what were, at the time, less conspicuous amendments to an older rule, Rule 14a-8, governing the "private ordering" process – that is, the process by which shareholders may make submit proposals for changes to the company's bylaws or procedures, which would be voted on at the annual meeting. Rather than establish minimum proxy access standards by government rule, the amended version of Rule 14a-8 would allow any shareholder who has held at least $2,000 of stock for more than a year to propose a vote to change the proxy access procedure spelled out in a company's governing documents. (Some states require higher equity thresholds for the results of such ballots to be considered binding, although Delaware, the most important locus of incorporation, is not one of them. Some states do not permit shareholders to pass any binding changes to company bylaws. Among companies in the S&P 500 Index, about 3 percent prohibit any shareholder bylaw amendments.)[14]

While the changes to Rule 14a-8 had been stayed by the SEC pending the outcome of the 14a-11 review, with that case now settled, the SEC lifted the stay. In November 2011, the nonprofit United States Proxy Exchange (USPX) published what it called a "model" proposal for shareholders seeking to use 14a-8. The USPX proposal called for any band of shareholders who combined to hold at least 1 percent of the company's stock for at least two years, or that consisted of at least 100 members who each personally held at least $2,000 of stock for at least one year, to nominate directors to a company's board. Within weeks, the first two proposals based on the USPX model were filed, at MEMC Electronic Materials Inc. and Textron Inc.[15]

Others were to come, with the USPX model also used for 2012 proxy access proposals at Chiquita Brands Inc.; Dell Inc.; Goldman Sachs Group; Princeton National Bancorp; Ferro Corp.; Sprint Nextel Corp.; and Bank of America Corp.[16] In February 2012, Princeton National became the first company to allow the proposal to be included in its proxy, although management recommended shareholders vote it down.[17] The widespread dissemination of the model came in the face of claims that it appeared to endorse illegal solicitations. As Ethan Mark of the Minneapolis-based law firm Stinson Leonard Street LLP wrote:

> When the SEC adopted the now invalidated Rule 14a-11, it noted that when nominating shareholders band together, any related communications would be deemed solicitations under the proxy rules (See Release No.33-9136, page 205). The SEC, in conjunction with Rule 14a-11, adopted exemptions from the proxy solicitation rules to permit shareholders to band together without violating the proxy rules. Those rules however did not expand beyond the now invalidated Rule 14a-11 (see page 215 of the foregoing

12. Ibid.

13. Securities and Exchange Commission, "Order Granting Stay," File No. S7-10-09, Oct. 4, 2010. http://www.sec.gov/rules/other/2010/33-9149.pdf

14. Beth Young, "The Limits of Private Ordering," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, Nov. 24, 2009. http://corpgov.law.harvard.edu/2009/11/24/the-limits-of-private-ordering/

15. James McRitchie, "Proxy Access: Two Proposals Filed, More USPX Members Needed," CorpGov.net, Nov. 16, 2011. http://www.corpgov.net/2011/11/9652/

16. Memorandum, "SEC Responds to Proxy Access No-Action Requests," Simpson Thacher & Bartlett, March 15, 2012. http://www.stblaw.com/content/Publications/pub1383.pdf

17. James McRitchie, "PNBC 1st to Allow USPX Model Proxy Access Proposal," CorpGov.net, Feb. 1, 2012. http://www.corpgov.net/2012/02/pbnc-1st-to-allow-uspx-model-proxy-access-proposal/

Release). So how will the groups of 100 small shareholders be lawfully formed?[18]

In addition to the filings – primarily from large individual investors – that used the USPX form, Norges Bank Investment Manager submitted 14a-8 proposals to eight companies: Charles Schwab Corp.; Wells Fargo & Co.; Western Union Co.; Staples Inc.; Pioneer Natural Resources Co.; CME Group Inc.; KSW Mechanical Services Inc.; and Microwave Filter Co. For all but KSW and Microwave Filter, which had higher thresholds, the Norges proposals called for granting proxy access to shareholders who held at least 1 percent of shares for more than a year.

All told, of the 17 USPX and Norges proxy access proposals, 13 were challenged by the companies, who each submitted letters to the SEC seeking "no action" on the company's decision to omit or disqualify the proposals. In March 2012, the SEC responded by granting "no action" relief to six of those companies. The SEC acknowledged claims by Bank of America, Goldman Sachs and Textron that the shareholders had violated rules limiting them to just one proposal. They also concurred with Chiquita, MEMC and Sprint that the submitted proposals were excessively vague.[19]

All six of the companies granted relief had faced USPX proposals. The Norges proposals fared somewhat better, as the SEC denied arguments by Western Union and Wells Fargo that they should be permitted to omit the proposals on grounds that they were "false and misleading" because they instructed shareholders to refer to a website that was not yet complete. They also denied KSW's argument that the proposal should be excluded on grounds that it already had a bylaw permitting shareholders with at least a 5 percent stake to nominate directors.[20] While it wasn't a successful argument, this strategy of using existing or proposed proxy access standards to fight more liberal proxy access standards would prove crucial in more recent challenges.

OPENING THE FLOODGATES

Of the 24 shareholder proxy access proposals submitted in 2012, 13 went to a vote. Institutional Shareholder Services Inc., the largest U.S. proxy advisory firm to hedge funds and mutual funds, recommended supporting six of those proposals. Of those six, four were proposed by Norges and all four failed. However, the proposals at energy company Chesapeake Energy Corp. and oil and gas drilling contractor Nabors Industries Ltd. were successful. In what would prove a portent of things to come, both of the successful initiatives were sponsored by the five NYC Public Pension Funds, who combine to hold roughly $160 billion of assets.[21]

The number of ISS-endorsed shareholder proxy access proposals nearly doubled to 11 in 2013, but only three (CenturyLink Inc.; Verizon Communications Inc.; and again, Nabors Industries, again sponsored by the New York City pension funds) were successful.[22] In 2014, there were 13 such proposals and six were successful. Of the successful ballots, three (Abercrombie & Fitch Co., Big Lots Inc. and, for the third time, Nabors Industries) were sponsored by the New York City pension funds. The Philadelphia Public Employees Retirement System also was successful with a proxy access proposal at Boston Properties Inc. The two cities' pension funds also came close to success on two other proxy access initiatives, with a New York proposal at Kilroy Realty Corp. and a Philadelphia proposal at Comstock Resources Inc. each earning 47 percent of votes cast. [23]

What the six successful ballots, as well as the "near misses" at Comstock and Kilroy, all had in common was that they established a higher baseline ownership threshold of a 3 percent stake for at least three years. Shareholder communication firm Georgeson Securities noted in a 2014 report that overall support for initiatives to adopt proxy access rose from an average of 31.7 percent of votes cast in 2013 to 39.1 percent in 2014. Among the eight initiatives with the higher threshold, support averaged 55.7 percent.[24]

That lesson was not lost on New York City Comptroller Scott M. Stringer, a politician sufficiently shrewd that he managed to prevail in the 2013 primary race for comptroller against the much better-known former governor of New York, Eliot Spitzer. In November 2014, Stringer announced a staggeringly bold initiative. Acting in his capacity as administrator of the city's pension funds, he submitted proxy access proposals to 75 companies for votes at their 2015 annual meetings.[25] For all 75 proposals, Stringer was recommending proxy access be granted to shareholders who maintained a 3 percent stake for at least three years.

18. Ethan Mark, "Shareholder rights group promotes model proposal for proxy access," Lexology, Nov. 10, 2011. http://www.lexology.com/library/detail.aspx?g=f67899d9-589a-4bb7-8fe8-e50389f0dc80

19. Memorandum, "SEC Responds to Proxy Access No-Action Requests," Simpson Thacher & Bartlett, March 15, 2012. http://www.stblaw.com/content/Publications/pub1383.pdf

20. Ibid.

21. Rajeev Kumar, "2012 Annual Corporate Governance Review," Georgeson Inc., 2012. http://www.computershare-na.com/sharedweb/georgeson/acgr/acgr2012.pdf

22. Rajeev Kumar, "2013 Annual Corporate Governance Review," Georgeson Inc, 2013. http://www.computershare-na.com/sharedweb/georgeson/acgr/acgr2013.pdf

23. Rajeev Kumar, "2014 Annual Corporate Governance Review," Georgeson Inc, 2014. http://www.computershare-na.com/sharedweb/georgeson/acgr/acgr2014.pdf

24. Ibid.

25. Eric Sumberg, "Comptroller Stringer, NYC Pension Funds Launch National Campaign to Give Shareowners a True Voice in How Corporate Boards Are Elected," Office of the New York City Comptroller, Nov. 6, 2014. http://comptroller.nyc.gov/newsroom/comptroller-stringer-nyc-pension-funds-launch-national-campaign-to-give-share-owners-a-true-voice-in-how-corporate-boards-are-elected/

While announcing his belief that "stronger board oversight leads to better long term performance," Stringer made clear in an accompanying chart that firms' financial performance was not actually his top priority. Of the 75 companies, 33 were targeted because they were in carbon-intensive industries; 24 were targeted for having insufficient numbers of women or racial and ethnic minorities on their boards; and 25 were cited for having received "significant opposition" in advisory votes on executive compensation. A handful of the firms – including Cabot Oil & Gas Corp., Whiting Petroleum Corp., Cimarex Energy Co. and Cloud Peak Energy Inc. – were cited in more than one category.[26] As he put it in a press release announcing the creation of his so-called Boardroom Accountability Project:

> Resolutions were filed at companies where we see risks associated with climate change, board diversity and excessive CEO pay. Especially when it comes to the environment, business as usual is no longer an option. To effect true change, you need the ability to hold entrenched and unresponsive boards accountable and that is what we are seeking to do.[27]

But for companies targeted by Stringer, there remained one potential out clause. Activist shareholder James McRichie – a prominent member of USPX and for 20 years the publisher of the popular corporate governance portal CorpGov.Net – had filed a proxy access proposal with Whole Foods. The company requested a "no action" letter from the SEC on grounds that it was already sponsoring its own proxy access proposal – requiring a threshold of 9 percent ownership for at least five years – in its 2015 proxy documents. In December 2014, the SEC's Division of Corporation Finance granted the request, finding that "inclusion of both proposals would present alternative and conflicting decisions for the stockholders and would create the potential for inconsistent and ambiguous results."[28]

The precedent set by Whole Foods sparked a chain reaction among other companies facing proxy access proposals. First up was Marathon Oil Corp., one of the Stringer-targeted companies, which filed a no action letter with the SEC arguing their situation was "identical to the matters in conflict in Whole Foods where "no action" relief was granted to the company."[29] They were followed just a day later by a similar request from Cabot Oil & Gas.[30] Within a month, that pair was joined by Exelon Corp., Apache Corp., Chipotle Mexican Grill Inc., Noble Energy Inc., SBA Communications Inc., Peabody Energy Corp. and Arch Coal Inc. – all of them among the companies targeted by Stringer and all of them arguing the pension funds' proxy access proposal conflicted with one of their own. Domino's Pizza Inc. also cited the Whole Foods precedent in a request to omit a proxy access proposal, while AES Corp., another Stringer-targeted company, sought to fight the proposal on technical grounds.[31]

But McRitchie appealed to the SEC commissioners to reverse the commission staff's decision on his Whole Foods proposal, arguing that it "effectively limits shareholders to consideration of proposals sponsored by the board of directors and eliminates any opportunity for shareholders to present alternative criteria."[32] The Council of Institutional Investors, an influential trade association whose members sponsored roughly a third of the shareholder proposals of all types in 2014, also wrote to the SEC asking that the commission rethink its approach.[33] While conceding that proxies should not contain two binding proposals that seek opposite ends, CII said there was no apparent conflict in the Whole Foods case, which involved two similar proposals – one binding and one non-binding – with slightly different terms:

> That limitation blunts the communicative value of the vote shareholders do have: If shareholders defeat Whole Foods' management proposal, it will not be clear to the company if the vote reflects opposition to access generally or opposition to Whole Foods' much less useful access formulation (and/or possibly to the gamesmanship many observers perceive Whole Foods as having engaged in here).[34]

The commission would shortly make clear that it was taking those arguments seriously. On Jan. 16, 2015, SEC Chairwoman Mary Jo White issued a statement that due to "questions that have arisen about the proper scope and application" of the rule governing directly conflicting proxy access

26. Boardroom Accountability Project, "2015 Company Focus List," Office of the New York City Comptroller, Nov. 6, 2014. http://comptroller.nyc.gov/boardroom-accountability/bap-companies/

27. Eric Sumberg, "Comptroller Stringer, NYC Pension Funds Launch National Campaign to Give Shareowners a True Voice in How Corporate Boards Are Elected," Office of the New York City Comptroller, Nov. 6, 2014. http://comptroller.nyc.gov/newsroom/comptroller-stringer-nyc-pension-funds-launch-national-campaign-to-give-shareowners-a-true-voice-in-how-corporate-boards-are-elected/

28. Evan S. Jacobson, "Response of the Office of Chief Counsel," Division of Corporation Finance, Securities and Exchange Commission, Dec. 1, 2014. http://corpgov.net/wp-content/uploads/2014/12/WFM-no-action-granted.pdf

29. J. Eric Johnson, "RE: Marathon Oil Corporation," Locke Lord LLP, Dec. 17, 2014. http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/nycityemployee121714-14a8-incoming.pdf

30. A.J. Ericksen, "Re: Cabot Oil & Gas Corporation," Baker Botts LLP, Dec. 18, 2014. http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/nyccomptroller121814-14a8-incoming.pdf

31. Jill Radloff, "Proxy Access: More File to Exclude Proposals," *Dodd-Frank and the Law*, Jan. 9, 2015. http://dodd-frank.com/proxy-access-more-file-to-exclude-proposals/

32. James McRitchie, "Request for Reconsideration," Dec. 23, 2014. http://corpgov.net/wp-content/uploads/2014/12/McRitchieAppealNo-action12-23-2014.pdf

33. Ann Yerger, "RE: Whole Foods Market and 14a-8(i)(9) interpretations," Council of Institutional Investors, Jan. 9, 2015. http://www.cii.org/files/issues_and_advocacy/correspondence/2015/01_09_15_CII_to_SEC_re_Whole_foods.pdf

34. Ibid.

proposals, she had directed SEC staff to review the rule and prepare a report.[35] Simultaneously, the SEC's Division of Corporation Finance dropped a bomb of its own – given the controversy, it would not grant any further no action relief during the 2015 season.[36]

THE 2015 PROXY SEASON

There were 108 proxy access proposals in advance of the 2015 proxy season,[37] more than triple the total number that previously had been considered in the three-year history of the updated Rule 14a-8. Some company boards responded to the shareholder petitions by voluntarily adopting proxy access as part of their bylaws. That includes several who were on the Stringer list – such as CF Industries Holdings Inc.,[38] HCP Inc.[39] and United Therapeutics Corp.[40] – as well as a number who were not, including General Electric Co.,[41] Yum Brands Inc.,[42] Biogen Inc.,[43] Kindred Healthcare Inc.,[44] McKesson Corp.[45] and H&R Block Inc.[46]

Going into the season, the Business Roundtable continued to press the case that shareholder proxy access proposals that directly conflict with management proposals remained an area lacking clarity. Pending further guidance on the topic from the SEC, the Roundtable appealed to the two major proxy advisors – ISS and Glass Lewis – not to make voting recommendations in cases where there were conflicting proxy access proposals. In a January 2015 letter to both groups, the Roundtable noted that companies could continue to rely on existing precedent to omit proxy access proposals even without explicit no action relief from the SEC.[47]

> The boards of public companies have a responsibility to make sure that the matters presented for a shareholder vote comply with the federal proxy rules. However, the Division's announcement means that companies may have no choice but to consider litigation if they want to adjudicate their rights under Rule 14a-8. Moreover, due to the timing of Division's announcement, it may not be realistic for companies to litigate the matter in advance of the deadline for finalizing their proxy materials. The Business Roundtable, therefore, believes that it would be inappropriate for ISS and Glass Lewis to apply their voting policies in a way that substitutes their own judgment as to the appropriate course of action in place of the Board's judgment.

Rejecting the Roundtable's appeal, ISS published formal guidelines in February that recommended yes votes on access proposals that called for ownership thresholds of not more than 3 percent for not more than three years.[48] Subsequent endorsements for that position would come from the Council of Institutional Investors, the California State Teachers' Retirement System, T. Rowe Price and TIAA-CREF.[49] Vanguard endorsed a 5 percent threshold for at least three years, while BlackRock and Glass Lewis indicated they'd continue to weigh such votes on a case-by-case basis.

Based on Schedule 14A filings with the SEC, and with a still-undetermined number of proposals that have been postponed, withdrawn, contested or omitted, 65 shareholder-sponsored proxy access proposals have gone to ballot through the end of June 2015, including 46 that were on the list of companies targeted by the New York City comptroller. Together, these 65 firms had a combined market capitalization of nearly $3.3 trillion, based on closing prices of July 1, 2015.

All told, 39 of the 65 ballots earned majority support, for a 60 percent success rate and average support of 55.4 percent. In all cases, the proposal included a 3 percent ownership threshold for at least three years and in nearly all cases (Citigroup and Apache Corp. supported the proposals, while Republic Services was neutral), management opposed the

35. Mary Jo White, "Statement from Chair White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals," Securities and Exchange Commission, Jan. 16, 2015. http://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html

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39. HCP Inc. Form 8-k, Feb. 11, 2015. http://www.sec.gov/Archives/edgar/data/765880/000110465915008888/a15-4243_18k.htm

40. United Therapeutics Corp., Form 8-K, April 29, 2015. http://www.getfilings.com/sec-filings/150430/UNITED-THERAPEUTICS-Corp_8-K/

41. General Electric Co., Form 8-K, Feb. 6, 2015. http://www.getfilings.com/sec-filings/150211/GENERAL-ELECTRIC-CO_8-K/

42. Yum Brands Inc., Form 8-K, Feb. 27, 2015. http://www.getfilings.com/sec-filings/150227/YUM-BRANDS-INC_8-K/

43. Biogen Inc., Form 8-K, March 27, 2015. http://www.getfilings.com/sec-filings/150327/BIOGEN-INC_8-K/

44. Kindred Healthcare Inc., Form 8-K, March 26, 2015. http://www.getfilings.com/sec-filings/150327/KINDRED-HEALTHCARE-INC_8-K/

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47. John Engler, "BRT Letter in Response to Recent SEC Announcements on Conflicting Proposals," Business Roundtable, Jan. 23, 2015. http://businessroundtable.org/resources/brt-letter-response-recent-sec-announcements-conflicting-proposals

48. ISS, "2015 Benchmark U.S. Proxy Voting Policies," Feb. 19, 2015. http://www.iss-governance.com/file/policy/2015faquspoliciesonselectedtopics.pdf

49. Tim Human, "Proxy access: what happens next?," *IR Magazine*, June 9, 2015. http://www.irmagazine.com/articles/proxy-voting-annual-meetings/20813/proxy-access-what-happens-next/

TABLE I: SUCCESSFUL 2015 PROXY ACCESS BALLOTS

Company	Support (%)	Sector	Size ($B)	Symbol
AES Corp.	66	Utilities	9.34	AES
Alliance Data Systems	98	IT	18.34	ADS
Alpha Natural Resources	67	Energy	0.07	ANR
American Electric Power	67	Utilities	26.55	AEP
Anadarko Petroleum	59	Energy	39.00	APC
Anthem	67	Health Care	13.89	ANTX
Apache Corp.	93	Energy	21.41	APA
AvalonBay Communities	65	Financials	21.68	AVB
Avon Products	76	Cnsmr Staples	2.72	AVP
CBL & Assoc.	69	Financials	2.76	CBL
CF Industries Holdings	57	Materials	15.19	CF
Cheniere Energy	63	Energy	16.27	LNG
Chevron	55	Energy	180.28	CVX
Cimarex Energy	56	Energy	10.33	XEC
Citigroup	87	Financials	168.00	C
Cloud Peak Energy	71	Energy	0.28	CLD
Community Health	50	Health Care	7.43	CYH
ConocoPhillips	54	Energy	74.62	COP
Devon Energy	58	Energy	23.79	DVN
DTE Energy	62	Utilities	13.67	DTE
Duke Energy	63	Utilities	50.16	DUK
eBay	59	IT	75.14	EBAY
EOG Resources	51	Energy	47.03	EOG
FirstEnergy Corp.	71	Utilities	14.02	FE
Freeport-McMoRan	64	Materials	19.14	FCX
Hasbro	69	Cnsmr Discr.	9.45	HAS
HCP Inc.	55	Financials	17.10	HCP
Hess Corp.	51	Energy	18.88	HES
Kohl's	73	Cnsmr Discr.	12.49	KSS
Marathon Oil	63	Energy	17.37	MRO
McDonalds	62	Cnsmr Discr.	92.18	MCD
Monsanto	54	Materials	50.69	MON
Murphy Oil	53	Energy	7.37	MUR
Occidental Petroleum	62	Energy	58.17	OXY
PPL Corp	61	Utilities	19.91	PPL
Range Resources Corp.	61	Energy	8.11	RRC
Republic Services Inc.	90	Industrials	13.86	RSG
St. Jude Medical	73	Health Care	20.53	STJ
TCF Financial	60	Financials	2.81	TCB
Vertex Pharmaceuticals	58	Health Care	30.10	VRTX

SOURCE: R Street analysis of Schedule 14A filings
Companies targeted by Comptroller Stringer are shaded in gray.

ballot in question. Stringer was successful on 31 of 46 ballots, for a 67 percent success rate.

Broken down by sector, there were 22 votes at energy companies, 15 of which were successful; eight votes at utilities, six of which were successful; seven votes in the consumer discretionary sector, three of which were successful; six votes in the consumer staples sector, one of which was successful; six votes in the financial sector, five of which were successful; three votes in the industrials sector, one of which was successful; three votes in the information technology sector, two of which were successful; three votes in the materials sector, all three of which were successful; and two votes in the telecommunications sector, both of which failed.

The 39 companies that saw successful proxy access proposals had a combined market capitalization of $1.25 trillion, including $879.4 billion among those targeted by Comptroller Stringer and $656.3 billion among energy and utilities companies. While nearly two-thirds of companies that have cast proxy access ballots approved them, companies representing more than two-thirds of the market capitalization among this

TABLE 2: UNSUCCESSFUL 2015 PROXY ACCESS BALLOTS

Company	Support (%)	Sector	Size ($B)	Symbol
Alexion Pharmaceuticals	45	Health Care	40.82	ALXN
Amazon.com	41	Cnsmr Discr.	203.83	AMZN
Apple	39	IT	728.42	AAPL
Arch Coal	36	Energy	2.84	ACI
Boston Properties	46	Financials	18.69	BXP
Cabot Oil & Gas	45	Energy	12.83	COG
Chipotle Mexican Grill	35	Cnsmr Discr.	18.93	CMG
Coca Cola	41	Cnsmr Staples	172.13	KO
CONSOL Energy	47	Energy	4.99	CNX
Domino's Pizza	46	Cnsmr Disc.	6.26	DPZ
Exelon Corp.	44	Utilities	27.60	EXC
Expeditors International	35	Industrials	8.83	EXPD
Exxon Mobil Corp.	49	Energy	347.62	XOM
Level 3 Communications	44	Telecom	18.58	LVLT
NVR Inc.	42	Cnsmr Discr.	5.45	NVR
PACCAR Inc.	42	Industrials	22.95	PCAR
Peabody Energy	49	Energy	0.52	BTU
Pioneer Natural Resources	49	Energy	20.63	PXD
Rite Aid	37	Cnsmr Staples	8.47	RAD
SBA Communications	46	Telecom	14.88	SBAC
Southern Co.	46	Utilities	38.96	SO
United-Guardian	12	Cnsmr Staples	0.09	UG
Walgreens	40	Cnsmr Staples	92.10	WBA
Wal-Mart	17	Cnsmr Staples	231.43	WMT
Westmoreland Coal Co.	36	Energy	0.37	WLB

SOURCE: R Street analysis of Schedule 14A filings Companies targeted by Comptroller Stringer are shaded in gray.

cohort rejected them, thanks largely to failed proxy access initiatives at corporate giants like Amazon.com, Apple, Coca Cola, Exxon Mobil Corp. and Wal-Mart. But one expects activist shareholders to bring forth similar initiatives at these and other companies next year, and in subsequent years.

PROBLEMS WITH PROXY ACCESS

At this point, it is fair to ask whether the trend toward enhanced and expanded proxy access for shareholders is not, in fact, a social good. Shareholders are firms' owners. Where current management have been derelict in their duties, failed to maximize value or otherwise engaged in conduct of which shareholders do not approve, why shouldn't it be easier to replace directors and move governance in a new direction? In an October 2013 working paper, researchers Jonathan Cohny and Jay Hartzell of the University of Texas and Stuart Gillan of the University of Georgia broke down stock market reaction to three notable news events to examine the degree to which investors value this theoretical path to maximizing returns.[50] The exogenous events the researchers studied were Sen. Chris Dodd's June 16, 2010 announcement that the Dodd-Frank Act would require the SEC to set a rule granting proxy access to any shareholder with at least a 5 percent stake; the June 24, 2010 decision to strike that proposal in favor of granting the SEC authority to determine whether and at what level to set minimum proxy access; and the Oct. 4, 2010 announcement that the SEC would delay implementation of its rule in response to the challenge from the U.S. Chamber and Business Roundtable.

Cohny, Hartzell and Gillan did indeed confirm the best-case scenario for proxy access. Unexpected announcements that promised to grant shareholders greater control were associated with gains in share prices at "poorly performing firms" with large institutional investors identified as "shareholders likely to exercise control."

However, important to the experience of activist proxy access proposals that thus far have been put forward, those gains all but disappeared at firms with large stakes by investors "who might pressure firms to adopt labor-friendly policies, such as unions and public pension funds." This, the researchers found, "suggests that allowing certain types of shareholders greater control might actually detract from shareholder value."[51]

Thomas Stratman and J.W. Verret of George Mason University conducted a similar analysis of another unexpected regulatory development: the Aug. 25, 2010 decision by the SEC to apply the proxy access not only to large-cap firms (those with market capitalizations over $700 million) but also to smaller firms with capitalizations of between $75 million and $700 million. (The rule was to be delayed for three years for firms with capitalizations under $75 million).[52]

Looking at the differential effects for firms just above and just under the arbitrary $75 million cutoff, they found abnormally negative returns for those firms subject to the rule where minority investors held stakes of at least 3 percent. Stratman and Verret estimate promulgating the rule actually led to $347 million in stock market losses among their sample of about 1,000 small companies.[53]

In the most comprehensive analysis to-date of the market impact of proxy access, Ali Akyol of the University of Melbourne and colleagues looked at the effects of 17 related exogenous events from September 2006 through September 2010 on a sample of 4,719 U.S. and Canadian firms. Consistently, they found that events increasing the probability of proxy access resulted in abnormally negative returns, while events that decreased the probability of proxy access resulted in abnormally positive returns. Adding cross-sectional analysis of firms with institutional investors who held stakes sufficient to pass the access threshold confirmed that "the rule affects the returns of firms with more eligible institutional investors more negatively than other firms, in line with these firms being more likely to receive director nominations under the new rule."[54]

Our examination of the 65 proxy access votes conducted thus far in the 2015 season provides further empirical support for the effects observed by earlier analysts. While most of the proxy ballots were sufficiently decisive that their outcomes likely could have been predicted – and incorporated into the market price of the underlying equity securities – in advance of the votes, there were 15 votes where support for ballot access fell in the narrow band of 45 percent to 55 percent. For these 15 stocks, the ballot's outcome could plausibly have come out either way.

Taking an even narrower slice of that already small sample, 10 of the 15 companies all came from the energy sector. By focusing on those 10 firms -- five of which ultimately approved proxy access and five of which rejected it – we can credibly contrast their performance against a common baseline: the S&P Energy Select Sector Index, as tracked by the Energy Select Sector SPDR Fund (XLE). Comparing the

50. Jonathan B. Cohn, Stuart Gillan and Jay C., Hartzell, "On Enhancing Shareholder Control: A (Dodd-) Frank Assessment of Proxy Access," SSRN, Oct. 22, 2013. http://ssrn.com/abstract=1742506 or http://dx.doi.org/10.2139/ssrn.1742506

51. Ibid.

52. Thomas Stratmann and J. W. Verret, "Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?" *Stanford Law Review*, Vol. 64, No. 6, pp. 1431-1468, June 2012. http://ssrn.com/abstract=1960792

53. Ibid.

54. Ali C. Akyol, Wei Fen Lim and Patrick Verwijmeren, "Shareholders in the Boardroom: Wealth Effects of the SEC's Rule to Facilitate Director Nominations," Journal of Financial and Quantitative Analysis, June 7, 2010. http://ssrn.com/abstract=1526081

opening and closing prices of each stock on the day the company's proxy ballots were cast, versus the opening and closing prices of the sectoral index on those same dates, we can derive how much additional value the market assigned to news of the ballot's outcome.

The results support the supposition that investors do not positively value news that a firm has passed proxy access, but they did positively value news that a proxy access initiative failed. Of the five firms that passed proxy access, four saw their stock prices drop from open to close on the day of the vote. Of the five firms that rejected proxy access, four saw their stock prices climb from open to close on the day of the vote.

Comparing performance against that of the Energy Select Sector SPDR Fund on the days in question, we find virtually no difference between the performance of the successful proxy access firms and that of the sector as a whole. The five firms that passed proxy access did, on average, outperform the sector, but only by 0.01 percentage points. By contrast, the five firms that rejected proxy access outperformed the sector by 1.18 percentage points.

Using the difference between those two outcomes, we can posit the counterfactual that firms which approved proxy access would have seen share prices that are 1.17 percent higher if shareholders had, instead, rejected proxy access. Multiplying that by the $1.25 trillion combined market capitalization of the 39 firms that have approved proxy access in 2015, the result is as much as $14.6 billion in potential shareholder value foregone as a result of the votes.

Obviously, only limited confidence can be invested in this result, given the small sample size, the fact that results are limited to pension fund-sponsored initiatives in a single sector and the inability to discount other performance-related information *sui generis* to the firms in question. The observation is offered only to note that recent events appear to comport with historical experience documented in the literature.

Of course, it also isn't just short-term returns where the negative impacts of proxy fights are seen. There is a lengthy literature looking at the longer-term aftermath at firms where more traditional proxy battles have been waged, and the results are fairly dismal:

- **A 1993 paper** looking at the stock returns of 97 firms subject to proxy battles between 1968 and 1987 found that, 24 months after the battle was complete, firms where dissidents gained at least one board seat had underperformed peers by 32.6 percent and firms where dissidents gained a majority underperformed peers by 40.8 percent.[55]

TABLE 3: RELATIVE PERFORMANCE POST-PROXY VOTE

Company	Voting Date	Share Price Performance	
		Company	XLE
Chevron	27-May	-0.09	-0.11
ConocoPhillips	12-May	0.17	0.61
EOG Resources	30-Apr	-1.05	-0.69
Hess Corp.	6-May	-0.75	-1.29
Murphy Oil	13-May	-0.84	-1.13
Cabot Oil & Gas	23-Apr	0.33	-0.46
CONSOL Energy	6-May	0.64	-1.29
Exxon Mobil Corp.	27-May	1.16	-0.11
Peabody Energy	4-May	2.41	-0.5
Pioneer Natural Resources	20-May	-1.15	-0.16

SOURCE: R Street analysis of MarketWatch share price data. Companies with successful proxy access votes are shaded in gray

- **A 1992 paper** on proxy contests in which dissidents won control of a board between July 1962 and January 1978 found that, two years later, the firms underperformed peers by 22.8 percent.[56]
- **In a March** 1995 paper for the Federal Reserve Bank of New York, economist Michael Fleming examined the outcomes of 185 threatened proxy fights between 1977 and 1988. He found that, for the 27 firms where dissidents won board seats, 24-month returns were 19.4 percent lower than for those where they did not.[57]

If the goal of proxy access is to maximize shareholder value, as Comptroller Stringer and other activist investors claim, the outcomes shouldn't be anywhere near this consistently bad.

The problem is summarized best by Stanford Law School professor Joseph Grundfest, writing in the American Bar Association journal *The Business Lawyer*. The SEC's interest in promulgating mandatory proxy access, Grundfest maintains, was always explicitly motivated by politics, rather than the best interests of shareholders, as the commission's "powers of introspection are insufficient to divine the value-maximizing will of the different shareholder majorities at each corporation subject to the agency's authority."[58]

55. David Ikenberry and Josef Lakonishok, "Corporate Governance through the Proxy Contest. Evidence and Implications," *Journal of Business*, Vol. 66, No. 3, pp. 405-435, July 1993. http://www.jstor.org/stable/2353207?seq=1#page_scan_tab_contents

56. Lisa Borstadt and Thomas Zwirlein, "The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance," *Financial Management*, Vol. 21, No. 3, pp. 22-34, Autumn 1992. http://www.jstor.org/stable/3666016?seq=1#page_scan_tab_contents

57. Michael Fleming, "New Evidence on the Effectiveness of the Proxy Mechanism," Federal Reserve Bank of New York Research Paper No. 9503, March 1995. http://www.newyorkfed.org/research/staff_reports/research_papers/9503.html

58. Joseph A. Grundfest, "The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law," *The Business Lawyer*, Vol. 65, No. 2, pp. 361-394, February 2010.

> From a political perspective, and consistent with the agency capture literature, the Proposed Rules are easily explained as an effort to generate benefits for constituencies allied with currently dominant political forces, even against the will of the shareholder majority. Viewed from this perspective, the Proposed Rules have nothing to do with shareholder wealth maximization or optimal corporate governance, but instead reflect a traditional contest for economic rent common to political brawls in Washington, D.C.[59]

Where minority shareholders have a vested interest in promoting their own pet causes, even if they have no hope of winning elections, Grundfest explains they may impose "megaphone externalities" on the corporation as a whole. Explicitly or implicitly, the threat of using the proxy ballot to draw attention to their set of issues becomes a point of leverage that may be traded for other concessions. Rarely is the goal actually to maximize shareholder wealth.

Even where the aims of a short slate of director candidates – that is, those put forward by shareholders without any intent to gain control of the board – aren't explicitly political, evidence is scant that successful minority shareholder candidates actually provide the diversity of thought and perspective that one might hope. In his 2012 book "Corporate Governance after the Financial Crisis," University of California at Los Angeles law professor Stephen Bainbridge postulated the primary effect is simply "divided boards representing differing constituencies."[60]

> The likely effects of proxy access therefore will not be better governance. It is more likely to be an increase in interpersonal conflict (as opposed to the more useful cognitive conflict). There probably will be a reduction in the trust-based relationships that are the foundation of effective board decision making. There may also be an increase in the use by the majority of pre-meeting caucuses and a reduction in information flows to the board as a whole.[61]

What's important to remember is that sitting directors are sworn to uphold fiduciary duties of care and loyalty. Nominating committees, being comprised entirely of independent directors, are bound by that same code. The fiduciary duties of directors aren't simply a theoretical abstraction; they are enforced both in criminal law and in the civil context of shareholder class actions.

http://www.jstor.org/stable/41806628?seq=1#page_scan_tab_contents

59. Ibid.

60. Stephen M. Bainbridge, "Corporate Governance after the Financial Crisis," First Edition, Oxford University Press, p. 230, Jan. 25, 2012.

61. Ibid.

Thus, writes Bernard Sharfman in the *Journal of Corporation Law*, the more that authority for nominating directors is transferred from nominating committees of directors, who are bound by fiduciaries duty, to the mass of shareholders, who are unaccountable and may have opportunities to extract rents for their own factional interests, the less certainty the majority shareholders actually have that their interests will be safeguarded:

> In sum, proxy access is an inefficient tool of accountability, creating the expectation that its use will reduce shareholder wealth, not increase it. The responsibility for director nominations is being shifted from the corporate apparatus that has the greatest informational advantage in understanding the needs of the corporation, the board of directors, to certain shareholders who do not possess such an advantage and indeed may have little information in that regard.[62]

CONCLUSION

Now that it is rapidly becoming a "new normal," proxy access is likely to prove a genie stubbornly unwilling to be returned to the bottle. It also must be conceded that this development isn't entirely bad. When wielded by the appropriate parties, proxy access does hold at least some promise to act as a counter to the myopic tunnel vision or never-ending echo chamber that bedevils some underperforming boards.

But while it isn't an unmitigated bad, one hopes the evidence in this paper demonstrates amply that nor is proxy access an unqualified good. Proxy access can be an invitation to mischief. We should expect opportunistic figures, both in the public and private sectors, to continue to exploit it in proxy seasons to come.

Though each would require significantly more research to ascertain their potential benefits and drawbacks, we offer these five policy recommendations to counter the misapplication of proxy access:

1. **Clarity on conflicting proposals** – The SEC must act swiftly to provide clarity with respect to the degree to which companies are free to omit shareholder proposals for proxy access that conflict directly with director proposals. Where a board has adopted bylaw changes permitting proxy access or submitted a binding proxy access question to shareholders via proxy ballot, it should have safe harbor to avoid the expense of administering elections on the same question raised by shareholder initiative, whose outcome would not be binding.

62. Bernard S. Sharfman, "Why Proxy Access is Harmful to Corporate Governance," *Journal of Corporation Law*, Vol. 37, No. 2, Winter 2012. http://ssrn.com/abstract=1873469

2. **Preserve state laws of incorporation** – While the vast majority of proposals that have been forwarded to date have been precatory, one imagines the next frontier by ambitious activist shareholders will be to test binding initiatives. The SEC must underscore companies' freedom (and obligation) to disqualify binding proposals that would be considered improper under state law. For example, companies must continue to be able to avail themselves of advance notice requirements permitted under state law. Companies also must continue to be able to avail themselves of state law protections that permit limiting the submission of binding questions to shareholders who have a certain minimum stake, or to subjecting some kinds of questions to supermajority thresholds before they may be considered binding. There is a threat of creeping federalization of incorporation law, which must be resisted.

3. **Limit "nuisance" filings** – To discourage "nuisance" initiatives, companies should be granted safe harbor to omit or disqualify identical proposals from the same set of shareholders in consecutive proxy seasons. The "megaphone externality" imposed on firms is real and there is currently no incentive to constrain certain kinds of activist investors from forcing firms to bear the cost of politically motivated proxy campaigns, year after year.

4. **Exempt small and medium filers** –With its decision to table Rule 14a-11, the SEC appears to have shelved its plan to study the impact of mandatory proxy access on small filers (those below $75 million in market capitalization). But given the research from Stratman and Verret demonstrating the outsized costs proxy access can have even on medium-sized filers (those between $75 million and $700 million in market capitalization), Congress should consider granting relief from Rule 14a-8 proxy access initiatives for all but the largest filers.

5. **Expand fiduciary duties** – To the extent that proxy access transfers significant power from boards of directors to shareholder advisory services, there may be a future need to re-examine – either in statute or at common law – whether the board's fiduciary duties and responsibilities must similarly be extended to such entities.

6. **Constrain activist politicians** – The emergence of major state and municipal pension funds as leading players in the activist investor landscape counsels several related reforms. To the extent feasible, such funds should never be under the direct administration of elected officials. Congress might consider amending the Employee Retirement Income Security Act to cover public pensions as qualifying plans and rescinding sovereign immunity for public pension administrators who violate their fiduciary obligations to plan members. Finally, in concert with the general need to address long-term funding challenges faced by many public pension plans, there should be a concerted effort to transition to defined contribution systems. Grandstanding of the sort engaged in by New York City's comptroller would be impossible if the authority to determine investment allocations were transferred from the politicians to the workers themselves.

It remains too early to say whether the emergence of proxy access will herald the return of the sorts of incompetent governance that vexed Adam Smith. But given its potential to hurt shareholders and further constrain U.S. firms' access to capital, it's a development that must be monitored closely in the years ahead.

ABOUT THE AUTHOR

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He is a three-time award winner from the American Society of Business Publication Editors and was the youngest-ever winner of a first place prize from the New Jersey Press Association. He also is the former public affairs director of the Independent Institute in Oakland, Calif., and the former state chapters coordinator of the Republican Liberty Caucus.

His writings have appeared in the San Francisco Chronicle, Wall Street Journal, Roll Call, CQ, The Hill, Townhall.com, Reason, The American Spectator, Orlando Sentinel, Travel Weekly and Folio magazine, among other publications.