

DISTILLING THE DEBATE ON PROXY ACCESS

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In August 2010, the SEC issued its final rule on proxy access, which gives shareholders the right to place director nominees directly on the company's proxy card, thereby sparing shareholders a large part of the expense of waging a traditional proxy contest.¹ This rulemaking, and the SEC's subsequent decision in October to delay implementing the rule pending a challenge from the Business Roundtable, has fueled a vigorous debate on the merits of proxy access and the details of its implementation.² Some of the arguments made by commentators and academics are particularly interesting and useful in framing the contours of the debate.

The central arguments that support proxy access are founded in enhanced board accountability and responsiveness. Supporters contend that proxy access will make board elections more competitive and less of a rubber stamp for the board's nominees.³ In turn, this should make boards more responsive to shareholders and increasingly vigilant in performing their oversight duties to avoid potential election defeats.⁴ Supporters also argue that since board oversight lapses played a significant role in the recent financial crisis, the time is ripe for governance reforms that increase board accountability.

A second and related line of arguments used by supporters is that shareholders need proxy access to adequately exercise their state law right to elect and remove board members.⁵ Without proxy access, supporters claim that shareholders cannot

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¹ 17 C.F.R. pts. 200, 232, 240, and 249 (2010).

² Bus. Roundtable & Chamber of Comm. of U.S., Securities Act Release No. 9149, Exchange Act Release No. 63,031, Investment Company Act Release No. 29,456 (Oct. 4, 2010).

³ *Proxy Access*, COUNCIL OF INSTITUTIONAL INVESTORS, <http://www.cii.org/resourcesKeyGovernanceIssuesProxyAccess> (last visited Nov. 20, 2010).

⁴ *Id.*

⁵ See, e.g., Paul Atkins, *The SEC's Sop to Unions*, WALL ST. J., Aug. 27, 2010, at A15.

effectively exercise this right given the prohibitively high expenses of a traditional proxy contest. The numbers support this assertion: Marcel Kahan and Edward Rock report that over 99% of elections are uncontested,⁶ which does not comport with the notion of shareholders effectively exercising their role in board elections.

Proxy access opponents have a number of compelling rebuttal arguments. A primary contention is that proxy access will lead to the nomination of “special interest directors,” such as individuals representing unions or those with social or environmental agendas.⁷ Even if these individuals do not win election, dissenters contend that their presence on the ballot will force companies to become overly focused on politically charged issues at the expense of creating long-term shareholder value, thereby harming the firm’s competitiveness.⁸ Dissenters envision that these candidates, for example, might attempt to extract concessions from boards in exchange for removing their name from the ballot—a form of “proxy access greenmail.”⁹ A recent study by Bo Becker, Daniel Bergstresser, and Guhan Subramanian that examines stock price effects surrounding the SEC’s proxy access rule announcements, however, finds that firms most likely to be affected by proxy access have experienced abnormal positive gains as a result of the announcement, suggesting value in proxy access.¹⁰

Other opposition arguments include the contention that proxy access is not required in order to promote board responsiveness in light of the recent shift by many companies to majority voting rules,¹¹ as well as the claim that high-quality directors might be discouraged from serving on boards if they are more likely to face electoral competition from shareholder nominees.¹² Finally, some dissenters take issue with the requirement that shareholders (or a group of investors) must own 3% of the company’s shares for a minimum of three years before gaining proxy access to nominate directors, claiming that these requirements improperly discriminate between shareholders holding the same class of stock.¹³

In contrast to the interesting points made by the supporters and dissenters, perhaps the most intriguing argument comes from Kahan and Rock: that the proxy access rules will have little to no impact on the status quo, particularly for large,

⁶ Marcel Kahan & Edward B. Rock, *The Insignificance of Proxy Access* 18–19 (U. Pa., Inst. for Law & Econ. Research Paper No. 10-26; N.Y.U. Law and Econ. Research Paper No. 10-51), available at <http://ssrn.com/abstract=1695682>.

⁷ See Atkins, *supra* note 5.

⁸ *Id.*

⁹ See Kahan & Rock, *supra* note 6, at 84.

¹⁰ Bo Becker, Daniel Bergstresser & Guhan Subramanian, *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge* 14 (Harvard Bus. Sch. Fin., Working Paper No. 11-052), available at <http://ssrn.com/abstract=1695666>.

¹¹ 17 C.F.R. pts. 200, 232, 240, and 249 (2010).

¹² See Becker, Bergstresser & Subramanian, *supra* note 5, at 2, 14.

¹³ See Atkins, *supra* note 5.

widely held firms.¹⁴ They bolster this contention in several ways. First, they argue that the 3%, three-year requirement is a tough obstacle that will limit proxy access.¹⁵ Given that the twenty largest public retirement funds combined own only 2.8% of Goldman Sachs and the ten largest pension funds hold less than 2.5% of Bank of America, this claim seems plausible, especially with respect to large corporations.¹⁶ Kahan and Rock also contend that not many shareholder concerns under the current status quo go unaddressed—in 2009, only eleven firms in the Russell 3000 index received a majority withhold vote and failed to make a satisfactory response¹⁷—suggesting a limited number of situations in which proxy access will be useful. Finally, Kahan and Rock argue that shareholders who want to take an activist position already have a sizeable array of tactics available to them, such as sponsoring shareholder resolutions, campaigning for withhold votes, running a traditional proxy contest, or asking a company to place a certain person on the board.¹⁸ They argue that the availability of proxy access, though a new option for activism, is not enough to induce activism by investors, such as mutual funds, that have not been active in the past or have only been active in very limited high-stakes situations.¹⁹

Essentially, the proxy access debate will generate heightened shareholder awareness of corporate governance issues, but it is not clear that the rule will produce real governance changes. If Kahan and Rock are right, proxy access may be more of a symbolic corporate governance reform than one of practical consequence.

¹⁴ See generally Kahan & Rock, *supra* note 6.

¹⁵ *Id.* at 2.

¹⁶ Alain Sherter, *SEC “Proxy-Access” Rule Won’t Really Help Shareholders Manage Big Companies*, BNET (Aug. 26, 2010, 10:29 AM), <http://www.bnet.com/blog/financial-business/sec-8220proxy-access-8221-rule-won-8217t-really-help-shareholders-manage-big-companies/7233>.

¹⁷ Kahan & Rock, *supra* note 6, at 86.

¹⁸ *Id.* at 87–88.

¹⁹ *Id.* at 88.