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Regulatory: Lessons companies can learn from proxy access proposals

Proactively address shareholder concerns to avoid proposals for proxy access

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The 2012 proxy season evidences the fact that many retail and institutional shareholders continue to be actively involved in looking out for what they perceive to be the best interests of companies in which they have invested their capital. In particular, shareholders continue to show an interest in being able to have a say in who serves as a director, whether that be by means of a proxy contest (or threatened proxy contest), submitting a nominee for consideration as a director or submitting a shareholder proposal to amend the company's charter documents to allow qualified shareholders to place a director nominee on the company's annual proxy statement (so-called "proxy access" proposals).

With regard to proxy access proposals, it seems likely the pace of such proposals will increase over the next few years. Indeed, two such proposals recently won shareholder approval, and this will likely encourage other shareholders to push for proxy access, particularly at small and mid-size companies where shareholders believe they can have an immediate impact. While the pace of such proposals will likely increase, it is also probable that companies will continue to resist such proposals and will not file their own proxy access proposals or agree to accept and enact proxy access proposals instead of having the proposals go to a shareholder vote.

Given this stand-off, it is best for companies to do what they can to avoid receiving a proxy access proposal. This is best done by proving to shareholders that the company's directors are effectively acting as protectors of shareholder value and defenders of the company's assets and reputation. To prove this, companies will need to address the following list of reasons shareholders have identified for submitting proxy access proposals:

- Poor corporate governance practices and lack of shareholder rights
- Unresponsiveness to shareholder concerns
- Excessive executive pay and poor executive compensation practices, including the absence of a clawback policy
- Poor financial and stock performance
- Lack of board independence from management and poor board practices, including long tenured directors and directors with little or no shareholdings in the company.

The reasons identified for submitting a proxy access proposal carry with them the obvious lessons for companies hoping to avoid receiving one. Namely, that companies need to demonstrate to their shareholders that they have good corporate governance practices, that interests of their directors are aligned with shareholders through share ownership and that they have an independent board that is not beholden to management. However, there is a deeper lesson that companies should learn: the lesson that actively listening to shareholders can be a good thing, not a bad thing. Shareholders who believe a company is willing to listen to and try to address their questions and concerns are less likely to submit shareholder proposals.

This is not to suggest that a company should meekly accept any demand made by shareholders. Rather it suggests that a company should set a tone where shareholders are not viewed as an adversary, but as a voice, sometimes an important voice, that can provide insights and advice into the path the company is pursuing. For example, exchange rules suggest one key component of an annual meeting is to provide shareholders with an opportunity to discuss the company's affairs with management (see Nasdaq Rule 5620). By listening to and carefully assessing what shareholders are saying, management, including the board of directors, will put itself in a more fully informed position, and will be better prepared to communicate with shareholders about significant issues confronting the company. Management will also be better prepared to effectively oversee the company and carry out its fiduciary duties.

About the Author

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