

# Memorandum

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## SEC Allows Exclusion of Proxy Access Shareholder Proposal Due to Conflict with Management Proposal

December 8, 2014

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### Introduction

On December 1, 2014, the Securities and Exchange Commission (“SEC”) issued a no-action letter, much awaited by the corporate community, to Whole Foods Market, Inc., concurring with the company that it may omit a proxy access shareholder proposal from its 2015 proxy materials.<sup>1</sup> The shareholder proposal, submitted by James McRitchie pursuant to Rule 14a-8, asked the Whole Foods board to amend the company’s governing documents to allow any shareholder or group of shareholders collectively holding at least three percent of the company’s shares for at least three years to nominate directors, which the company would then be required to list on its proxy statement. The proposal added that parties nominating directors “may collectively make nominations numbering up to 20% of the Company’s board of directors, or no less than two if the board reduces the number of board members from its current size.”

The Whole Foods board decided to submit a proxy access proposal of its own for shareholder approval at the company’s 2015 annual meeting. The company’s proposal would amend Whole Foods’ bylaws to permit any shareholder (but not a group of shareholders) owning at least nine percent of the company’s common stock for five years to nominate board candidates on the company’s proxy statement. The company’s proposal would allow a shareholder to nominate the greater of one director or ten percent of the board, rounding down to the nearest whole number of board seats.

In its no-action request, Whole Foods relied on Rule 14a-8(i)(9), which permits exclusion of a shareholder proposal “[i]f the proposal directly conflicts with one of the company’s own proposals to be submitted to shareholders at the same meeting.” Whole Foods argued that “a company may exclude a shareholder-

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<sup>1</sup> See [Whole Foods Market, Inc.](#) (avail. Dec. 1, 2014).

sponsored proposal where it seeks to address a similar right or matter as is covered by a company-sponsored proposal even if the terms of the two proposals are different or conflicting.” Whole Foods took the position that the company’s proxy access proposal “seeks to address the same right as” the shareholder proposal and that given the disparities between the two proposals, the proposals directly conflict with one another. According to Whole Foods, submitting both proposals “would present alternative and conflicting decisions for the Company’s shareholders that would likely result in inconsistent and ambiguous results.” The SEC concurred that the shareholder proposal may be excluded from Whole Foods’ proxy materials.

### **Increasing Submissions of Proxy Access Shareholder Proposals**

The proposal received by Whole Foods is one of numerous proxy access shareholder proposals submitted to public companies for inclusion in their 2015 proxy materials. The increasing popularity of proxy access shareholder proposals is due in part to New York City Comptroller Scott M. Stringer’s initiative to submit such proposals to 75 companies on behalf of the New York City pension funds he oversees. According to Stringer, his “Boardroom Accountability Project” is “a national movement to systemically improve the responsiveness of corporate boards to shareowners.”<sup>2</sup> Stringer’s campaign targeted companies in diverse industries and with a range of market capitalizations but that purportedly have weak track records on the issues of climate change, board diversity, or say-on-pay.

The Comptroller’s shareholder proposals, which are precatory, call for the adoption of a bylaw that would permit shareholders owning at least three percent of a company for three or more years the right to nominate director candidates, representing up to 25% of the board, and list them on the company’s ballot. The Comptroller’s campaign appears to be aimed to setting a global proxy access standard across companies with different market capitalizations.

### **Proxy Access Proposals in 2014**

Thus far, 16 proxy access shareholder proposals went to a vote at Russell 3000 companies this year. These proposals received an average of 35.1% shareholder support. Five proposals submitted to a vote among the Russell 3000 passed.

Notably, support levels for these proposals varied depending on the eligibility thresholds included in each specific proposal being advanced. Proposals with a 3%/3-year formulation received average shareholder support of approximately 53.4%, with six out of 10 of these proposals receiving over 50% of the vote. On the other hand, shareholder proposals seeking to provide proxy access to either (a) holders with at least 1% but less than 5% ownership for two years or (b) 25 holders of \$2,000 each with at least 1% but less than 5% for one year failed. These proposals received average shareholder support of only 5%. This meager shareholder

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<sup>2</sup> Press Release, [“Comptroller Stringer, NYC Pension Funds Launch National Campaign to Give Shareholders A True Voice in How Corporate Boards Are Elected”](#) (Nov. 6, 2014).

support is principally due to the fact that large institutional shareholders tend to disfavor low thresholds and the proxy advisory firms have not supported such proposals. Institutional Shareholder Services Inc. (“ISS”), for example, has expressed concern over the low 1% threshold, the potential for replacement of nearly half the board in a single election, and the fact that these proposals discriminate against 5% shareholders. Conversely, ISS has recommended that shareholders vote for the 3%/3-year proposals, which were modeled after the SEC’s vacated proxy access rule.

In 2014, four companies among the Russell 3000 sponsored their own proxy access resolutions. All four management proposals passed.

### **Significance of the SEC’s No-Action Letter to Whole Foods and Current Options for Responding to a Proxy Access Shareholder Proposal**

Whole Foods’ submission to the SEC marks the first time the SEC staff was charged with deciding whether a proxy access shareholder proposal could be excluded under Rule 14a-8(i)(9) due to an alternative proposal presented by the company. The SEC had previously declined to permit the exclusion of a proxy access shareholder proposal on the basis that the company had “substantially implemented” the proposal by adopting its own form of proxy access that required a higher shareholding threshold or a longer shareholding period as compared with the shareholder proposal.

The SEC’s no-action letter to Whole Foods provides public companies with an additional option for responding to shareholder proposals seeking proxy access. Given the decision of the SEC staff on the Whole Foods matter, public companies can generally choose from among the following strategies when receiving a proxy access shareholder proposal:

- Negotiate a compromise with the shareholder proponent, which may involve the adoption of a proxy access bylaw with different requirements than those in the shareholder proposal;
- Submit a competing proxy access proposal with different terms and obtain a no-action letter from the SEC to exclude the shareholder proposal; or
- Include the shareholder proposal in the company’s proxy materials, accompanied by a persuasive board statement in opposition to the proposal.

There may not be one optimal approach for all companies. Before making any decisions, each company should gain an understanding of the particular shareholder proponent’s agenda, determine how the company’s largest institutional shareholders are likely to vote (based on their voting guidelines and vote history on proxy access proposals), and learn how the major proxy advisory firms are likely to recommend that shareholders vote on the proposal. It may be advisable to retain a proxy solicitor and/or other expert(s) to collect data on the inclinations of the company’s largest shareholders, predict the range of shareholder approval that the proposal will likely receive, and advise on the most favorable approach to take given the

company's specific circumstances.

That said, there are several general points that companies faced with a proxy access proposal should keep in mind:

- The Comptroller's office does not seem open to negotiating the 3% or 3-year thresholds. Additionally, the Comptroller's office has publicly stated that withdrawal of its proposal is predicated on an agreement on proxy access, not on any of the issues that caused companies to be selected to receive a proxy access proposal in the first place.
- Based on statistics from the last year, in which proxy access shareholder proposals with a 3%/3-year formulation enjoyed a relatively high rate of success, companies should, when evaluating their options for responding to a proxy access shareholder proposal, generally assume that such a proposal will pass if put to a shareholder vote.
- If the company either submits a competing proposal to shareholder vote or preemptively adopts a proxy access bylaw with higher eligibility thresholds, the proponent may come back with another shareholder proposal next year, seeking to reduce the thresholds. This is particularly true where the company's formulation of proxy access is significantly more stringent than the proponent's formulation.

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If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or [yafit.cohn@stblaw.com](mailto:yafit.cohn@stblaw.com), or any other member of the Firm's Public Company Advisory Practice.

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UNITED STATES

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New York  
425 Lexington Avenue  
New York, NY 10017  
+1-212-455-2000

Houston  
2 Houston Center  
909 Fannin Street  
Houston, TX 77010  
+1-713-821-5650

Los Angeles  
1999 Avenue of the Stars  
Los Angeles, CA 90067  
+1-310-407-7500

Palo Alto  
2475 Hanover Street  
Palo Alto, CA 94304  
+1-650-251-5000

Washington, D.C.  
1155 F Street, N.W.  
Washington, D.C. 20004  
+1-202-636-5500

EUROPE

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London  
CityPoint  
One Ropemaker Street  
London EC2Y 9HU  
England  
+44-(0)20-7275-6500

ASIA

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Beijing  
3919 China World Tower  
1 Jian Guo Men Wai Avenue  
Beijing 100004  
China  
+86-10-5965-2999

Hong Kong  
ICBC Tower  
3 Garden Road, Central  
Hong Kong  
+852-2514-7600

Seoul  
West Tower, Mirae Asset Center 1  
26 Eulji-ro 5-gil, Jung-gu  
Seoul 100-210  
Korea  
+82-2-6030-3800

Tokyo  
Ark Hills Sengokuyama Mori  
Tower  
9-10, Roppongi 1-Chome  
Minato-Ku, Tokyo 106-0032  
Japan  
+81-3-5562-6200

SOUTH AMERICA

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São Paulo  
Av. Presidente Juscelino  
Kubitschek, 1455  
São Paulo, SP 04543-011  
Brazil  
+55-11-3546-1000