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Proxy Access Shareholder Proposals - Where Are We Now?

In July 2011, the U.S. Court of Appeals for the D.C. Circuit rejected as “arbitrary and capricious” the SEC’s new Rule 14a-11 that would have affirmatively allowed shareholders to have their board candidates included in the company’s proxy materials, subject to certain conditions. The SEC decided not to appeal that decision and instead implemented Rule 14a-11’s companion amendments to Rule 14a-8(i)(8), which amendments narrowed the “director election exclusion” to allow proxy access shareholder proposals.

The 2012 proxy season is the first under this regime, and 22 proxy access proposals are reported to have been submitted so far by individual and institutional investors in equal proportion. Those proposals generally follow six models, differing on various parameters such as shareholder eligibility requirements and whether the number of permitted shareholder nominees is capped. We are aware of at least 12 companies that have filed no-action requests with the SEC Division of Corporation Finance, and the SEC staff has responded to ten such requests so far, granting no-action relief in six cases and rejecting the requests in the other four. Successful arguments for exclusion to date are that the proxy access proposal constitutes multiple proposals or that the proposal is so vague and indefinite as to be false or misleading. Significantly, an unsuccessful argument was that a company could exclude a proposal based on “substantial implementation” where the company had already adopted a proxy access regime albeit one with a different, higher ownership threshold than the shareholder proponent’s proposal would have required. We discuss these proposals and the no-action requests and outcomes in more detail below.

Proxy Access Proposals Filed for the 2012 U.S. Proxy Season

Based on available information from Institutional Shareholder Services, 22 proxy access proposals have been submitted in the 2012 proxy season so far, with 11 proposals being submitted by individual investors and another 11 proposals being submitted by institutional investors. These proposals can generally be broken down into six models, differing on various parameters. Specifically, among the 22 proposals, minimum ownership requirements ranged from 1% (or \$2,000 of stock) to 15%, with 1% being the most common threshold submitted. The minimum holding period ranged from one month to three years, with one and two years being the most frequent holding period requirements. Twelve proposals included a cap on the number of board seats available to access nominees, and that cap was most often set at 25%, consistent with the cap in the SEC’s invalidated Rule 14a-11. Lastly, ISS indicates that eight proxy access proposals are binding. For more details on the different proxy access shareholder proposals submitted so far, please see the table on Exhibit A.

These differing flavors of proxy access proposals have, not surprisingly, resulted in different treatment both by the recipient companies as well as by the SEC.

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SEC Staff No-Action Responses on Proxy Access Proposals

One proxy access proposal has reportedly been withdrawn in return for the company's promise to submit a management-sponsored proxy access proposal in 2013. Of the 21 remaining proposals, we know of 12 no-action requests that have been submitted with the SEC Division of Corporation Finance. Earlier this month, Corporation Finance responded to ten of these requests, granting no-action relief to six, while rejecting the other four. While companies made numerous, alternative arguments in their no-action requests as to why their proxy access proposals should be excludable, Corporation Finance focused on the arguments discussed below as the basis for their decision to allow exclusion or not. We note that none of the no-action requests submitted by Delaware companies argued that these proxy access shareholder proposals violate state corporate law. These arguments were mooted by the adoption of Delaware General Corporation Law Section 112, which explicitly endorsed companies' ability to adopt proxy access bylaws. Companies incorporated in other jurisdictions (such as New Jersey and Kansas) did make this illegality argument although the SEC staff did not appear to focus on that analysis.

Successful Grounds for Exclusion

Multiple proposals under Rule 14a-8(c). In response to three proposals from individual investors, Corporation Finance granted no-action relief based on the Rule 14a-8(c) prohibition against a shareholder submitting more than one proposal to a company for a particular shareholder meeting. These proposals did not cap the number of board seats available to shareholder nominees and in order to address the possible triggering of any contractual or other change-in-control provisions to which the companies may be subject in the event of a change-over in a majority of board seats, the proposals added a provision to specify that such a majority change in board membership would not be considered to be a change-in-control by the company, its board and officers. Corporation Finance perceived this provision as a separate and distinct proposal from the provisions related more strictly to proxy access and thus determined that these proposals are excludable.

Vague and indefinite under Rule 14a-8(i)(3). In response to three other proposals from individual investors, Corporation Finance granted no-action relief because the proposals are so vague and indefinite as to run afoul of the prohibition under Rule 14a-8(i)(3) against materially false or misleading statements in proxy solicitation materials. Those proposals included a condition that shareholder nominees should satisfy the "SEC Rule 14a-8(b) eligibility requirement", without describing those specific eligibility requirements. The SEC staff noted that many shareholders are not familiar with the requirements of Rule 14a-8(b), and would therefore be unable to determine with any reasonable certainty the actions or measures the proposals require.

Two second-round proposals submitted by an individual investor have already attempted to address the above concerns by eliminating the change-in-control provision and also the reference to Rule 14a-8(b) eligibility requirements, reflecting the quick adaptability that shareholder proponents have become known for in recent years. It remains to be seen whether the companies at which these proposals were submitted will file no-action requests with the SEC.

Unsuccessful Grounds for Exclusion

Substantial implementation under Rule 14a-8(i)(10). In response to a proposal from an institutional investor, the SEC staff denied no-action relief. The proponent had sought to amend the company's bylaws to allow proxy access by any one or more shareholders who beneficially owned 2% or more of the company's stock. The subject company had already adopted a proxy access bylaw, but it differed from the proponent's proposed bylaw in various ways, including that the company bylaw had set the ownership threshold requirement at 5% or more of the company's stock and disallowed group aggregation of beneficial ownership for purposes of meeting that threshold. The SEC staff perceived the differences between the adopted bylaw and the one set forth in the proposal as significant enough to conclude that the company had not substantially implemented the proposal.

Website reference is false and misleading under Rule 14a-8(i)(3) or constitutes an untimely revision of the shareholder proposal. In response to three proposals from an investment manager, the SEC staff denied no-action relief with respect to the companies' request to exclude the portion of the proposals that referred to a website that purported to contain additional information regarding these proposals. Two companies argued that the website reference was excludable under Rule 14a-8(i)(3) because, among other things, the website was not operational at the time that the proposal was submitted and therefore the reference to such website for additional information was false and misleading. Another company argued that because the website would only become operational and populated with information when the company filed its proxy statement, the reference constituted an untimely revision of the proposal in violation of Rule 14a-8(i)(3). In denying this latter request for no-action relief, the SEC noted that the proponent had already provided the company with the substantive content that would be included on the website and most importantly, that Rule 14a-8(i)(3) permits the exclusion of a proposal only if it is false and misleading, which the company did not argue was the case.

The first of the pending proxy access proposals is expected to be voted on today. The outcome of that vote and the others to follow is difficult to predict and will be much anticipated. As we have already seen this season, it is clear that at least the individual investors will continue to push on this issue, and we are likely to see additional proposals this year or certainly in 2013.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum may be addressed to Ariel J. Deckelbaum (212-373-3546), David S. Huntington (212-373-3124), Stephen P. Lamb (302-655-4411) or Frances F. Mi (212-373-3185).

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EXHIBIT A

| Proponent | Number of proposals submitted | Shareholder eligibility | | Cap on shareholder nominees | Status |
|---------------------------------|-------------------------------|--------------------------|---------------------|--|---|
| | | Min. ownership threshold | Min. holding period | | |
| Various individual investors | 9 | 1%* | 2 years* | No overall cap, however, each stockholder is limited to the greater of one nominee or 12% of board | Six deemed excludable. One is the subject of a pending no-action request. Status of two is unclear. |
| Investment Manager | 6 | 1% | 1 year | 25% of board | Three deemed includable. One is the subject of a pending no-action request. Status of two is unclear. |
| Various institutional investors | 3 | 3% | 3 years | 25% of board | One withdrawn; management proxy access proposal to be submitted in 2013. Status of two is unclear. |
| Individual investor | 2 | 1% ** | 2 years ** | 12% of board and each investor group is allowed one nominee | Status unclear. |
| Institutional Investor | 1 | 2% | 1 year | None | Deemed includable. |
| Institutional Investor | 1 | 15% | 1 month | 33% of board | Status unclear. |

* Alternatively, a group of 100 investors who have each satisfied the SEC's Rule 14a-8(b) ownership thresholds, *i.e.*, have held \$2,000 of stock for one year, are eligible to include director nominees in the company's proxy materials.

**Alternatively, a group of 50 investors who each own company stock for one year worth \$2,000 determined within the prior 60 days are eligible to include director nominees in the company's proxy materials.

Source: Institutional Shareholder Services and public filings.