Preparing for the 2012 Proxy Season

What's New

December 14, 2011 by Russell Newsom

As the directors and officers of public companies know, the rules and regulations governing proxy materials are dynamic and continually changing. In the past year, for instance, one proxy access rule has been vacated and another has been implemented. This is a summary of the changes in the past year that may affect companies' 2012 proxy materials.

The Mandatory Proxy Access Rule Vacated (Rule 14a-11).

In the Summer 2011, the SEC's year-old but yet-to-be-implemented Rule 14a-11 was invalidated by the US Court of Appeals, DC Circuit. The SEC decided that, while it may revisit the issue in the future, it would not appeal the ruling. This means that the issue of mandatory proxy access has been shelved for now. The mandatory proxy access rule would have allowed shareholders or groups of shareholders holding at least 3% of the voting power of a company's securities (who must have also held their shares for at least three years) to force the company to include that group's nominees for directors in their proxy materials.

Private Ordering of Proxy Access (Rule 14a-8(i)(8)).

Subsequent to the mandatory proxy access rule being vacated, the SEC lifted a voluntary stay it had placed on an amendment to another rule, Rule 14a-8(i)(8), and the amendment took effect in September 2011. This amendment narrows a company's power to exclude shareholder proposals for the election of directors. Rule 14a-8(i)(8), prior to the amendment, allowed for liberal exclusion of shareholder proposals relating to the election of directors. The rule now requires companies to include in their proxy materials shareholder proposals providing for the adoption of a proxy access mechanism. This is known as the "private ordering" of proxy access.

Remaining Reasons to Exclude.

Under the amended rules providing for the private ordering of proxy access, there are still a few valid reasons to exclude a shareholder proposal for proxy access. For instance, if certain submission deadlines are not met by a shareholders' proposal, then that proposal can be excluded. (More specifically, certain separate proxy rules that apply to Rule 14a-8(i)(8) require shareholder proposals to be received at least 120 days before the anniversary date that the company's previous year's proxy statement was sent or those proposals can be excluded.) Other potential reasons to exclude shareholders' proposals could be provided by state law. The rules still allow for additional reasons for exclusion based on state law.

ISS 2012 Proxy Policies.

The leading proxy advisory firm, Institutional Shareholder Services Inc. ("ISS"), annually issues policies which can impact companies' proxy materials. Some of the most significant ISS policies relating to the 2012 proxy season are listed below.

- **Say-on-Pay Evaluation** - ISS has refined its policies on the Say-on-Pay regulations that became effective before the 2011 proxy season. When undertaking its Say-on-Pay evaluations, ISS compares executive compensation against total shareholder return ("TSR") for different time periods. In an effort to establish a longer term perspective for Say-on-Pay evaluations, ISS will now use a five-year TSR yardstick in addition to the one-year and three-year TSR yardsticks already in use. ISS also tweaked its Say-on-Pay evaluation policies and metrics in several other minor ways.
- **2011 Say-on-Pay Vote** - All companies who held a 2011 Say-on-Pay vote are required to discuss the results of the vote when determining its current compensation. While all companies who held a Say-on-Pay vote in 2011 are required to discuss the vote, ISS has indicated that they will specifically focus on companies whose compensation policies received less than 70% of the votes cast in their 2011 Say-on-Pay vote. ISS may recommend voting against Directors who are Compensation Committee members for such companies.
- **Newly Public Companies** – ISS' 2012 policies also indicate that it will now scrutinize the equity plans of newly public companies more closely and under additional standards.

Monitoring of Proxy Rule Changes.

The legal environment surrounding proxy materials will likely continue to evolve in the near future. Certain rules and regulations seem to be in flux. We will continue to monitor the changes and anticipate potential issues for our clients.