

Site Requirements

"Proxy Access' Shareholder Proposals in the Upcoming Proxy Season"

Fulbright Briefing

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October 18, 2011

Background

In August 2010, the Securities and Exchange Commission (SEC) adopted a controversial "proxy access" rule, Exchange Act Rule 14a-11. The rule created procedures applicable to all U.S. public companies by which shareholders that met specified stock ownership thresholds and other requirements could require the company to include director candidates nominated by those shareholders in the company's proxy materials. In July 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated the proxy access rule, and in September, the SEC announced that it would not appeal the court's decision despite its continuing commitment to finding a means of facilitating shareholder director nominations.

The SEC had adopted the proxy access rule in response to ongoing concerns about whether public company boards of directors are sufficiently focused on shareholder interests, and the desire of institutional shareholders and other shareholder activists to use the director nomination process as a tool for increasing board accountability and influencing corporate policy.

Although shareholders seeking changes at public companies will not have the proxy access rule at their disposal, public companies should be aware that shareholder activists will have an alternative tool available to them in the upcoming proxy season. On September 20, 2011, the SEC's amendments to Exchange Act Rule 14a-8 took effect. These rule amendments will enable shareholders to include proposals in company proxy materials recommending amendments to company bylaws that would give qualified shareholders proxy access for their own director nominees.

The Shareholder Proposal Rule as Amended

Rule 14a-8 enables shareholders to request that the company include their written proposals in the company's proxy materials, for consideration at the annual or special shareholders meeting to which the proxy materials relate. To be eligible to submit a proposal, the shareholder must meet the following modest eligibility requirements:

- continuously holding, for a year or more before submitting the proposal, no less than \$2,000 in market value, or 1%, of the securities entitled to vote at the shareholders meeting;
- continuing to hold the securities through the meeting date;
- submitting the proposal to the company by the applicable deadline, which for annual meetings is generally 120 calendar days before the anniversary of the mailing of the previous year's annual meeting proxy statement; and
- attending the meeting to present the proposal.

Companies can exclude a shareholder proposal from the proxy statement based on permitted grounds for exclusion enumerated in Rule 14a-8. Prior to the September 2011 amendments to Rule 14a-8, a company could decline to include a shareholder proposal in the proxy statement if it "relate[d] to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election." The September 2011 amendments narrowed this "election exclusion," codified as Rule 14a-8(i)(8), so that a company can no longer exclude a proposal that seeks to establish a procedure in the company's governing documents for the inclusion of shareholder director nominees in the company's proxy materials. However, the company can exclude a proxy access shareholder proposal if it:

- would disqualify a nominee standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, business judgment or character of one or more nominees or directors;
- seeks to include a specific individual in the company's proxy materials for election to the board of directors; or

- otherwise could affect the outcome of the upcoming election of directors.

These bases for exclusion had been established in several SEC no-action letters. In addition, the company can exclude a proxy access shareholder proposal if another basis for exclusion enumerated in Rule 14a-8 applies; for example:

- if the shareholder fails to satisfy the eligibility and procedural requirements of the rule;
- if the proposal would cause the company to violate applicable state, federal or foreign law;
- if the proposal or supporting statement is contrary to the SEC's proxy rules;
- if the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; or
- if the company has already substantially implemented the proposal.

With respect to excluding a shareholder proposal on grounds that it violates state law, note that in 2009, the State of Delaware (where many public companies are incorporated) amended its corporation law to expressly permit Delaware corporations to adopt proxy access bylaw amendments.

Preparing for Proxy Access Shareholder Proposals

For calendar year companies, the deadline for submitting shareholder proposals usually falls between November and January. The recent effectiveness of the amendments to Rule 14a-8 therefore paves the way for eligible shareholders to submit proxy access proposals for inclusion in companies' 2012 proxy statements, assuming no legal challenge to the Rule 14a-8 amendments postpones their effectiveness pending resolution.

Whereas Rule 14a-11 would have given qualifying shareholders immediate proxy access, the Rule 14a-8 amendments will enable proxy access in two steps:

- first, submission of a shareholder proposal that is included in the company's proxy statement, proposing changes to the company's bylaws to establish procedures by which qualifying shareholders can include their own director candidates in the company's proxy materials; and
- second, if the proposed bylaw amendments are adopted, following the newly established procedures so that shareholder director nominees are included in subsequent proxy materials of the company.

Proxy access accomplished through the Rule 14a-8 shareholder proposal process will also differ from proxy access under Rule 14a-11 in that proxy access shareholder proposals will be tailored to individual companies. For example, Rule 14a-11 required shareholders requesting proxy access to have held at least 3% of the voting power of the company's securities for three years; under Rule 14a-8, shareholders will be able to propose more lenient qualifying criteria that vary from company to company. However, since Rule 14a-8 limits shareholder proposals to 500 words, shareholders may encounter difficulty drafting detailed bylaw amendments with respect to particular companies, and may instead elect to draft proposals as advisory resolutions. In addition, independent proxy advisory firms such as Institutional Shareholder Services (ISS) could influence the design of shareholder proxy access proposals by promulgating guidelines for evaluating the proposals upon which voting recommendations to institutional shareholders will be based.

Although it is not possible to predict how widespread proxy access shareholder proposals will be in the upcoming proxy season, larger companies and companies with major shareholders that have expressed dissatisfaction with the company's performance, strategy, compensation policies or other corporate governance attributes, or a recent history of unresponsiveness to these concerns, are more likely targets.

To the extent that the company receives a proxy access shareholder proposal, the alternatives to be carefully reviewed with counsel include:

- excluding the proposal from the proxy statement under an established basis for exclusion;
- attempting to negotiate with the proponent for withdrawal of the proposal;
- if the board of directors considers the proposal inadvisable but the company lacks grounds for exclusion, including the proposal in the proxy statement with a negative recommendation from the board and an explanation of the reasons for not supporting the proposal;
- if the board of directors supports the proposal, either including it in the proxy statement as submitted, or negotiating changes with the proponent and including the proposal in the proxy statement as

revised;

- crafting an alternative proxy access proposal for inclusion in the proxy statement with a favorable recommendation of the board, and seeking to exclude the shareholder's proposal on grounds that it conflicts with the company's proposal; or
- amending the bylaws to enable proxy access in a manner supported by the board, and excluding the shareholder proposal on grounds that the company has already substantially implemented the proposal.

In connection with any of these alternatives, the company should consider meeting with key shareholders to discuss their views, or engaging a proxy advisory firm.

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