Proxy Access Proposals – Review of 2012 Results and Outlook for 2013

Shareholder Proposals Failed at Most Companies in 2012, but More Widespread Efforts, and Greater Success, Could Occur in 2013; Companies Should Consider Potential Advance Actions

SUMMARY
Pursuant to SEC rule changes that took effect in September 2011, shareholders are now permitted to submit and vote on “proxy access proposals” – that is, proposals to give shareholders the right to include director nominees in the company’s proxy materials. Over 20 such shareholder proposals (half of which were binding) were submitted during the 2012 proxy season, of which only nine have come to a vote. Many of the proposals that did not come to a vote were deemed excludable from proxy statements by the staff of the SEC for a variety of technical reasons. We have included on the following page a chart of the terms and outcomes of proxy access proposals submitted to date.

The vote results from this limited pool suggest that shareholders are hesitant to approve proposals that would give a proxy access right to holders of a small number of shares, but are more supportive of proposals that have ownership requirements that are similar to the 3%/3-year threshold that would have applied under the SEC’s now-vacated mandatory proxy access rule.

With the benefit of lessons learned in 2012, it seems likely that proponents will formulate more potent proxy access proposals in the future – both by avoiding the problems that allowed companies to exclude the proposals under SEC rules and by including thresholds that will achieve broader shareholder support. Companies should begin thinking about steps to prepare for and respond to such proposals, including maintaining a dialogue with key shareholders and monitoring market trends in this area. In addition, companies may wish to consider the terms of a proxy access provision that might be acceptable to the company. Although there seems to be little benefit to the unilateral adoption of a proxy access provision on a preemptive basis, there may be a benefit to a company in putting its own proxy access proposal up

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for a shareholder vote at an annual meeting, particularly because doing so should permit the exclusion of a conflicting shareholder proposal. We summarize at the end of this memorandum certain steps companies should consider taking, including potential terms that a company might find desirable if it were to put forth its own proxy access proposal.

Sullivan & Cromwell LLP will host a client webinar this summer to discuss proxy access, say-on-pay and other 2012 proxy season developments. Information on this webinar will be disseminated separately.

### SUMMARY OF 2012 PROXY ACCESS PROPOSALS

<table>
<thead>
<tr>
<th>Proponent</th>
<th>Company</th>
<th>Threshold/ Holding Period</th>
<th>ISS Rec.</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norges Bank (Binding)</td>
<td>Charles Schwab</td>
<td>1%/1 year</td>
<td>For</td>
<td>31% of votes cast</td>
</tr>
<tr>
<td>CME Group</td>
<td>1%/1 year</td>
<td>For</td>
<td>38% of votes cast</td>
<td></td>
</tr>
<tr>
<td>Pioneer Natural Resources</td>
<td>1%/1 year</td>
<td>For</td>
<td>Withdrawn in response to governance improvements</td>
<td></td>
</tr>
<tr>
<td>Staples</td>
<td>1%/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (conflicted with another bylaw)</td>
<td></td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>1%/1 year</td>
<td>For</td>
<td>32% of votes cast</td>
<td></td>
</tr>
<tr>
<td>Western Union</td>
<td>1%/1 year</td>
<td>For</td>
<td>33% of votes cast</td>
<td></td>
</tr>
<tr>
<td>Bank of America</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (multiple proposals)</td>
<td></td>
</tr>
<tr>
<td>Chiquita Brands</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (vague due to 14a-8 reference)</td>
<td></td>
</tr>
<tr>
<td>Dell</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (vague due to 14a-8 reference)</td>
<td></td>
</tr>
<tr>
<td>Ferro Corp.</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>Against</td>
<td>13% of votes cast</td>
<td></td>
</tr>
<tr>
<td>Forest Laboratories</td>
<td>1%/2 years or 50 holders of $2,000/1 year</td>
<td>N/A</td>
<td>Appears to be pending for August meeting. Proposal omits provisions SEC found problematic. SEC denied exclusion request</td>
<td></td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (multiple proposals)</td>
<td></td>
</tr>
<tr>
<td>Medtronic</td>
<td>1%/2 years or 50 holders of $2,000/1 year</td>
<td>N/A</td>
<td>Appears to be pending for August meeting. Proposal omits provisions SEC found problematic. SEC denied exclusion request</td>
<td></td>
</tr>
<tr>
<td>MEMC Electronics</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (vague due to 14a-8 reference)</td>
<td></td>
</tr>
<tr>
<td>Princeton National Bancorp</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>Against</td>
<td>32% of votes cast</td>
<td></td>
</tr>
<tr>
<td>Sprint Nextel</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (vague due to 14a-8 reference)</td>
<td></td>
</tr>
<tr>
<td>Textron</td>
<td>1%/2 years or 100 14a-8 holders/1 year</td>
<td>N/A</td>
<td>SEC deemed excludable (multiple proposals)</td>
<td></td>
</tr>
<tr>
<td>Various Pension Funds (Precatory)</td>
<td>Chesapeake Energy</td>
<td>3%/3 years</td>
<td>For</td>
<td>60% of votes cast</td>
</tr>
<tr>
<td></td>
<td>NABors Industries</td>
<td>3%/3 years</td>
<td>For</td>
<td>56% of votes cast</td>
</tr>
<tr>
<td>Amalgamated Bank (Precatory)</td>
<td>Hewlett Packard</td>
<td>3%/3 years</td>
<td>N/A</td>
<td>Withdrawn – HP to put forth proposal in 2013</td>
</tr>
<tr>
<td>D. Rudewicz/Furlong Fund (Binding)</td>
<td>Cadus Corp</td>
<td>1%/1 year</td>
<td>N/A</td>
<td>Not voted on</td>
</tr>
<tr>
<td></td>
<td>KSW</td>
<td>2%/1 year</td>
<td>Against</td>
<td>21% of votes cast. Issuer had adopted 5%/1 year provision</td>
</tr>
<tr>
<td></td>
<td>Microwave Filter</td>
<td>15%/1 month</td>
<td>N/A</td>
<td>Not presented at meeting. This was not a 14a-8 proposal – shareholder solicited separately</td>
</tr>
</tbody>
</table>
I. BACKGROUND

"Proxy access" refers to the right of shareholders to include their own nominees for director in the company’s proxy statement and on the company’s proxy card. As a state law matter, shareholders generally have the right to nominate directors. However, because substantially all shareholder voting occurs through the granting of proxies, as opposed to voting in person at the annual meeting, a shareholder nominee will not have a chance of being elected unless the nominating shareholder gathers proxies from other shareholders to vote for the nominee. Because creation and mailing of proxy soliciting materials (which requires the filing of a proxy statement with the SEC with specific detailed disclosures), as well as the actual solicitation effort, is very costly, election contests in which a shareholder solicits proxies have been relatively infrequent.

Vacating of Mandatory Rule. The SEC has, at various times, sought to allow a qualifying shareholder to include nominees in the company’s proxy materials, thereby avoiding the cost to the shareholder of preparing and mailing materials. Most recently, in August 2010, the SEC adopted Rule 14a-11, a mandatory proxy access rule, which would have allowed shareholders (or groups of shareholders) who have held 3% of the company’s voting securities for a three-year period to include director nominees in the company’s proxy materials.

Rule 14a-11 was subject to legal challenge by business groups shortly after its adoption, and the SEC stayed effectiveness of the rule (and all related rules) in October 2010. In July 2011, the U.S. Court of Appeals for the D.C. Circuit vacated Rule 14a-11 in its entirety, holding that the SEC did not adequately assess its costs and benefits. The SEC determined not to appeal this decision, and the SEC chairman has indicated recently that the Agency does not intend to pursue a mandatory proxy access rule in the near future.

Change to Rule 14a-8(i)(8). Rule 14a-8 permits shareholders who have owned at least $2,000 of shares of a company’s common stock for at least one year to include shareholder proposals in the company’s proxy statement. In adopting Rule 14a-11, the SEC also amended Rule 14a-8(i)(8), the so-called “election exclusion.” Prior to the revision, this provision allowed a company to exclude a shareholder proposal that related to the company’s election or nomination procedures. The amendment to Rule 14a-8(i)(8) narrowed this provision so that it allowed exclusion only of proposals that related to specific elections. The change to Rule 14a-8(i)(8) survived the vacating of the mandatory access rule, and went into effect in September 2011.

1 See Business Roundtable and Chamber of Commerce of the United States of America v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).
The effectiveness of the change to Rule 14a-8(i)(8) set the stage for so-called “private ordering” in the area of proxy access – that is, the development over time of a market standard or a range of market standards arising from the interplay of shareholder pressure and company reactions. Beginning with the 2012 proxy season, shareholders are now able to submit proposals under Rule 14a-8 that seek to cause the company to adopt proxy access bylaws.

Precatory vs. Binding Proposals. Shareholders may submit proxy access proposals either in the form of a “precatory” proposal requesting the board to adopt proxy access provisions, or in the form of a direct binding proposal that actually amends the bylaws to add proxy access provisions (because shareholders may, under the law of most states, amend the bylaws unilaterally). Shareholders have, in the past, tended not to advance governance-related proposals as binding bylaw amendments, largely because this requires them to draft the actual language of the bylaw amendment in a way that works with and is tailored for the company’s governing documents. In addition, many institutional investors are more likely to favor precatory proposals, because they believe that companies should be in charge of drafting specific bylaw language. Some shareholders, however, prefer to make binding proposals, because it prevents companies from diluting the impact of the proposal through nuances in drafting.

It should be noted that, if the board does not implement a successful precatory proposal, then the directors may face negative vote recommendations in subsequent years. For example, under the policies of Institutional Shareholder Services (“ISS”), the proxy advisory firm, directors will face negative vote recommendations if a precatory proposal receives the support of a majority of the outstanding shares, or receives the support of a majority of votes cast twice in three years, and the board does not implement the proposal in a way that ISS deems “responsive.”

II. 2012 PROXY ACCESS PROPOSALS

The following is a summary of the various forms of proxy access bylaws that were submitted for the 2012 proxy season:

A. NORGES BANK BINDING PROPOSALS (1%/1 YEAR)

Terms of Proposals. Norges Bank Investment Management, which manages the Norwegian government pension fund, submitted a number of binding bylaw amendments that would give a proxy access right to a shareholder or group that holds 1% of the outstanding stock and has held those shares for at least one year. Each eligible shareholder or group would be permitted to nominate up to 25% of the board. There is no overall limit on the number of nominees, though the number of access nominees actually elected to the board cannot exceed 25% of the board.

Selection of Issuers. Norges Bank, in its public filings and statements, indicated that it submitted proposals to S&P 500 companies that it believed had governance practices that were in need of
improvement. However, the specified governance deficiencies are, in some cases, nearly universal practices among U.S. public companies, such as the ability to issue blank check preferred stock and the right of the board to amend the bylaws unilaterally. Other specified governance problems at selected companies include combining the role of CEO and chairman, multiple share classes, lack of majority voting in director elections, lack of a shareholder right to act by written consent or call special meetings, and failure to implement (or to announce a plan to implement) successful shareholder proposals from prior years. Norges Bank also made statements indicating that they viewed efforts by a company to seek to exclude a shareholder proposal under SEC rules as a negative governance practice. Finally, in some, but not all, cases, Norges Bank highlighted that the company’s five-year total shareholder return was lower than at peer firms.

Norges Bank withdrew its proposal at one company, Pioneer Natural Resources, after the board approved the adoption of majority voting and destaggering of their board. It is not clear from company statements whether these actions (which were responsive to shareholder proposals on these topics that had passed in 2011) were in response to the Norges Bank proposal or dialogue with other shareholders, but Norges Bank stated that it viewed the actions as a successful outcome of their proposal.

**Norges Bank Publicity Efforts.** Norges Bank engaged in a number of novel publicity efforts in support of its proposals, which gave it the ability to make more detailed and expansive arguments than it could include in the proxy statement under SEC rules, which provide a 500-word limit for proponents’ supporting statements. First, Norges Bank included a link in each proposal to a website that had extensive, company-specific arguments in favor of their proposal. As noted below, the SEC staff viewed this reference to external materials as permissible. Second, Norges Bank filed a detailed slide presentation on the SEC’s Edgar system under Rule 14a-6(g). Filings under Rule 14a-6(g), which show up on the company’s Edgar website under form PX14A6G, are required by SEC rules if a holder of more than $5 million in stock engages in an exempt solicitation. It is unclear whether Norges Bank was required to make these filings under SEC rules, but an increasing number of shareholder proponents have used these filings on a voluntary basis, as a way of gaining broader publicity for their arguments in support of their proposals.

**Company Exclusion Efforts.** Most companies that received the Norges Bank proposal submitted exclusion requests to the SEC staff, arguing that the proposal was excludable as vague and indefinite because the internet address referenced in the proponent’s supporting statement did not lead to an active webpage. The SEC staff disagreed, noting that the proponent provided the companies with the

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4 Forty-five different companies have been the subject of PX14A6G filings so far in 2012, compared to 24 companies in all of 2011 and 21 in all of 2010.
information that would be on the webpage upon filing of the proxy statement, and that the companies did not allege that the webpage material was materially false or misleading. See letters to Charles Schwab, Wells Fargo and Western Union.\(^5\)

The only company that was able to exclude the proposal under SEC rules was Staples, and this was as a result of a drafting error in the proposal – a demonstration of the danger to proponents of submitting proposals in the form of binding proposals. In particular, the proposal failed to remove or qualify a statement in the existing bylaws that expressly disclaimed any shareholder right to include a nominee in the company proxy statement, and the SEC staff agreed that the resulting inconsistency made the proposal vague and indefinite.

**Voting Results.** The Norges Bank proposal failed at all the companies where it came to a vote, garnering the support of between 31% and 38% of shares voting, despite receiving a “for” recommendation in all cases from ISS.\(^6\) It seems likely that many institutional investors believed that a 1% threshold is simply too low.\(^7\)

**B. U.S. PROXY EXCHANGE FORM OF PROPOSAL (1%\(\times\)100 HOLDERS)**

**Terms of Proposals.** The most common form of proxy access proposal this year was based on a model issued by the United States Proxy Exchange, a shareholder advocacy group, which was tailored and submitted to a number of companies by individual shareholder activists. This precatory proposal requested a bylaw amendment permitting holders of 1% of the outstanding stock for a two-year period, or alternatively 100 holders who satisfy the $2,000/one-year requirement of Rule 14a-8, to include director nominees in the company’s proxy statement. The proposal would permit each eligible shareholder or group to nominate up to one-twelfth of the board, but had no overall limit on nominees or elected access directors. The proposal also provided that the company and its directors and officers could not consider the election of a majority of access nominees to be a “change in control.”

**Company Exclusion Efforts.** Every company that sought to exclude this proposal under SEC rules was successful in doing so. The SEC staff agreed with the companies that this proposal could be excluded on two separate bases:

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\(^5\) Western Union had initially advanced an alternative argument that the shareholder proposal was excludable under Rule 14a-8(i)(9) as conflicting with the company’s own proxy access proposal, which it intended to put to a shareholder vote at the 2012 annual meeting. The company withdrew this argument, however, when it decided that it would not, in fact, advance its own proxy access proposal this year.

\(^6\) ISS maintains that it does not have a bright line policy on proxy access proposal, but reviews them on a case-by-case basis, in light of the company’s shareholder base and the terms of the proposal.

\(^7\) For example, the [2012 proxy voting policies](#) of T. Rowe Price indicate that they support proposals suggesting an ownership level of at least 3%.
The proposal constituted multiple proposals in violation of Rule 14a-8(c), due to the inclusion of the provision stating that an election of proxy access nominees would not be a “change in control” of the issuer. See letters to Bank of America, Goldman Sachs and Textron.

The proposal was vague and indefinite under Rule 14a-8(i)(3) because it referred to the eligibility requirements of Rule 14a-8 without explaining what these requirements were. See letters to Chiquita Brands, Dell, MEMC Electronic Materials and Sprint Nextel.

Following the issuance of these SEC no-action letters, the U.S. Proxy Exchange issued a new form of proposal that eliminated the reference to Rule 14a-8 and the problematic “change of control” provision, and also reduced the 100 holder provision to 50 holders. According to the U.S. Proxy Exchange, proponents have submitted this form of proposal to Medtronics and Forest Laboratories. Both companies submitted exclusion requests to the SEC staff, arguing alternative bases for exclusion, but the exclusion requests were denied.

**Voting Results.** This form of proposal has come to a vote at only two companies – Ferro Corporation and Princeton National Bancorp – and received the support of 13% and 32% of the votes cast, respectively. ISS recommended against the proposal, noting that the 100 shareholder provision could allow a nominee supported by shareholders holding as little as $200,000 in shares, which represents a negligible percentage of the company.

**C. PRECATORY 3%/3-YEAR PROPOSALS**

**Terms of Proposals.** A coalition of state and municipal pension funds submitted precatory proposals at Nabors Industries and Chesapeake Energy – two companies that have been the subject of significant shareholder scrutiny and criticism – seeking to create a proxy access right for 3% shareholders (or groups) who have held their stake for at least three years. These thresholds are the same as those that would have applied under the SEC’s now-vacated mandatory proxy access rule.

**Selection of Issuers.** The proposals submitted at Nabors and Chesapeake detail the perceived governance failings that spurred the submission of the proposals, including excessive CEO compensation and low shareholder support for the say-on-pay vote and for certain directors in 2011.

**Voting Results.** These proposals passed at both Nabors (with the support of 56% of votes cast) and Chesapeake (with the support of 60% of votes cast). These companies have been experiencing above average levels of negative shareholder sentiment (for example, each company failed to receive majority approval of their 2012 say-on-pay vote), and it is possible that a 3%/3-year proposal would receive less support (and might fail) at other companies. Nevertheless, it seems likely that a proposal such as this one, which tracks the thresholds that the SEC sought to impose under its mandatory access rule, would achieve a significant level of support at many companies that did not already have any proxy access provisions at all.
Hewlett-Packard Withdrawn Proposal. A similar 3%/3-year precatory proposal was submitted to Hewlett-Packard by Amalgamated Bank, but was withdrawn when Hewlett-Packard agreed to put its own 3%/3-year proposal up for a vote at the 2013 annual meeting.

D. FURLONG FUND PROPOSALS

The final set of 2012 proxy access proposals consists of three different binding proposals advanced by the Furlong Fund LLC and its founder at relatively small companies.

Binding 2% Proposal. KSW, Inc. received a binding 2%/1-year proposal from the Furlong Fund. The proposal would have limited each nominating shareholder or group to one nominee, but had no overall cap on nominees. KSW argued to the SEC staff that it should be permitted to exclude the proposal because it was "substantially implemented" under Rule 14a-8(i)(10) by the company's adoption of a bylaw granting proxy access to 5% shareholders who had held for one year. The SEC staff disagreed, noting the differences between the proposal and the bylaw adopted by the company.

The outcome may have been different if KSW had been putting its own proxy access proposal up for a shareholder vote at the annual meeting. Under existing SEC staff precedents, if a company is actually putting its own proxy access provision to a shareholder vote at the upcoming annual meeting (which was not the case for KSW), then the company should be able to exclude a shareholder proxy access proposal as "conflicting" with the company's proposal under Rule 14a-8(i)(9), notwithstanding differences between the company proposal and the shareholder proposal.

In any event, the proposal went to a vote at the KSW annual meeting and received the support of only 21% of votes cast – a lower level of support than all but one of the 1% or 3% proposals received by other companies. Although it is difficult to draw conclusions from a single vote, it seems likely that a number of shareholders deemed the 5% proxy access right adopted by the company to be sufficient.

Binding 1%/1-year Proposal. Cadus Corporation received a binding 1%/1-year proposal from the managing member of the Furlong Fund. Like the KSW proposal, the Cadus proposal would have limited each shareholder or group to one nominee. This proposal was not, however, presented for a vote at Cadus's June 21 annual meeting.

Binding 15%/1-month Proposal. The Furlong Fund had also included a proxy access proposal as part of a proxy contest for board seats at Microwave Filter. The proposal was for a bylaw amendment providing a proxy access right to any 15% shareholder who had held for one month. This was not a Rule 14a-8 proposal to be included in the company's proxy statement, but rather a component of a contested election set forth in the dissident's own proxy filings. Ultimately, the proponent's director candidates, and the proxy access proposal, were withdrawn and not voted on at the meeting.
III. CONSIDERATIONS IN ADVANCE OF 2013 PROXY SEASON

The 2012 proxy season will likely be viewed as the start of a learning curve for shareholders and companies in the area of proxy access. Although the vast majority of proxy access proposals were either excluded under SEC rules or voted down by shareholders, the 2012 proxy season has given shareholder activists valuable information on how to craft proposals that have a better chance of success.

**Engage with Shareholders.** In anticipating the receipt of proxy access proposals for the 2013 proxy season, companies should consider the best ways to gauge the views of their largest shareholders on proxy access provisions, including their general views on the principle of proxy access, as well as specific provisions that they would or would not support. This background will be invaluable to management and the board in assessing how to deal with any proposals that are received. A number of institutional investors have expressed concern over proxy access proposals that have low thresholds or otherwise may be subject to abuse.  

**Consider Early Announcements of Governance Enhancements.** As discussed above, many companies became the target of proxy access proposals because of perceived deficiencies in governance practices or structures. To the extent a company is anticipating any actions that would be seen by shareholders as governance enhancements (such as adopting majority voting or destaggering the board), the company should consider announcing this action in the fall, before shareholder proposals are received, because it may have the side benefit of removing the company from the list of proxy access proposal targets.

**Preemptive Adoption of Proxy Access Has Limited Benefits.** Companies that wish to be in the forefront of governance practices might be drawn to the idea of adopting their own proxy access provisions unilaterally. This approach presents significant difficulties at this stage, and may have limited benefits. In the near term, there will be limited guidance as to how market practice will develop, and the terms that should be adopted. Proxy access bylaw provisions that are appealing to the company may not be appealing to shareholder activists, and the adoption by a company of its own proxy access provisions will not prevent shareholders from submitting proposals under Rule 14a-8(i)(8) to amend the company-adopted bylaw. For these reasons, there does not appear to be much benefit in acting preemptively and unilaterally, and few companies are expected to do so. The only way this approach would seem to be acceptable and not open to significant criticism would be if the company were to adopt provisions substantively identical to now-vacated Rule 14a-11.

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8  For example, as mentioned above, the 2012 proxy voting policies of T. Rowe Price indicate that they support proposals suggesting an ownership level of at least 3%. In addition, a governance expert at Blackrock has indicated their view that “any company establishing a proxy access process must have sufficient protections in place to avoid its abuse.”

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Evaluate Standard SEC Exclusion Bases. The SEC no-action letters issued in the 2012 season serve as a reminder that proxy access proposals will not be afforded special treatment under the SEC rules and will continue to be subject to exclusion under the traditional bases set forth in Rule 14a-8, as applicable. Upon receiving a proxy access proposal (or any other Rule 14a-8 proposal), companies should work with counsel to identify any viable grounds for exclusion, and should work with their investor relations team to determine whether appropriate shareholder engagement efforts might lead to the proposal being withdrawn.

Consider Potential Conflicting Management Proposal. If a company receives a proxy access proposal that it believes has a reasonable chance of passing in 2013, that has terms the company does not support (particularly a binding proposal), and that the company is not able to get withdrawn through dialogue with the proponent, one option would be for the company to submit its own proxy access bylaw and/or charter amendment for shareholder approval at the 2013 annual meeting. Under SEC Rule 14a-8(i)(9), a shareholder proposal can be omitted from the proxy statement if it conflicts with a company proposal being submitted for shareholder vote at the same meeting.9 This company proposal would likely be in the form of a bylaw and/or charter amendment adopted by the board, but with its effectiveness conditioned on receiving shareholder approval. This is a similar construct to that used in the context of special meeting proposals in recent years. The increased prevalence of shareholder rights to call special meetings at U.S. public companies can be largely attributed to the receipt by companies of shareholder proposals on this topic. However, the actual contours of the rights granted to shareholders have developed through management proposals, which contain various provisions designed to prevent abusive, wasteful or frivolous use of the right.

A similar dynamic could occur in the proxy access context – if shareholders begin to advance proxy access proposals that have a reasonable chance of passing, then companies may propose implementing provisions that have reasonable terms designed to prevent abuse. Companies may want to begin thinking now about the potential terms that a management proxy access proposal would have. If the company finds itself in the position of wanting to put forward a proposal at the 2013 annual meeting, there will be little time for management and the board to arrive at suitable terms. In particular, companies might want to consider such terms as the following:

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9 It should be noted that in a very limited number of situations, the SEC staff has refused to allow a company to exclude a conflicting shareholder proposal under Rule 14a-8(i)(9) when the company expressly acknowledged that it was submitting its own proposal as a reaction to receiving the shareholder proposal. See, e.g., Genzyme Corp. (Mar. 20, 2007). However, in recent years, the SEC staff has not followed this view, despite the objections of shareholder proponents.
Ownership threshold. For example, companies may decide that 5% is an appropriate threshold, because then the company and other shareholders would benefit from the disclosure requirement imposed on 5% shareholders or groups by the SEC’s Section 13(d) and (g) rules.¹⁰

Definition of ownership. Companies should consider whether ownership levels should be measured on a “net long” basis (that is, net of short sales, derivative hedges and other short provisions), in order to ensure that the nominating shareholders have a true economic stake in the shares that they hold.

Deadline for notice. The company’s existing advance notice bylaws may not provide a sufficient amount of time for the processing of candidates to be included in the company’s proxy statements. Companies may determinate that the deadline for notice should be earlier – for example, within a 30-day window ending on the Rule 14a-8 120-day deadline.

Treatment of incumbent access directors. Companies should consider whether incumbent directors who were access nominees should count against the maximum number of nominees for a number of years after their election, to prevent the company from having an incentive not to renominate them.

Nominee eligibility. A management-proposed proxy access provision might include a number of reasonable eligibility standards for access nominees, including independence under relevant stock exchange standards, eligibility for committee memberships, and the completion of a standard directors’ questionnaire.

Director qualifications. Even prior to the proposal of a proxy access provision, companies should consider whether to adopt bylaws setting out minimum qualification standards, or disqualification standards, that the company would apply to all its directors – for example, satisfaction of certain regulatory requirements, or prohibition on affiliations with competitors or conflicts of interest. Having such provisions in the bylaws may be helpful when proxy access is a possibility, because the company might then be faced with director nominees who were not subject to the nominating committee approval process. The adoption of such qualification provisions at a time when the company is faced with an actual shareholder nominee would likely attract greater scrutiny due to concerns of entrenchment – therefore, there is some benefit to doing so at an earlier stage.

Required Information. The company’s bylaws may provide for the provision of reasonable information about the candidate and the nominating party, similar to what is called for by typical advance notice provisions. In this regard, it should be noted that the SEC’s Schedule 14N, which was adopted in conjunction with Rule 14a-11, remains in effect and would apply in the case of a nomination under a company proxy access bylaw. The company bylaw should be drafted to work in conjunction with Schedule 14N.

Other limitations. Companies may determine to place reasonable limitations on the use of proxy access, including making it unavailable in a year where there is already a proxy contest in place, or restricting the resubmission of failed candidates who receive below a specified threshold of support.

We have worked with a number of clients on considering the terms of potential proxy access provisions, and have developed forms of term sheets, sample proxy access bylaws and other materials that can be tailored for a particular company’s circumstances. Please contact any of the lawyers listed at the end of

¹⁰ The SEC had adopted an exception from the loss of passive Schedule 13G status for shareholders who formed a nominating group under Rule 14a-11. It should be noted that, by its terms, this exception would NOT be available for shareholders acting to form a group under a company proxy access bylaw. See Exchange Act Rule 13d-1(c)(1).
this memorandum, or any other Sullivan & Cromwell lawyer you work with, if you are interested in discussing this matter further.

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June 19, 2012 (Updated as of July 9, 2012)
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CONTACTS
New York

Francis J. Aquila +1-212-558-4048 aquilat@sullcrom.com
John E. Baumgardner, Jr. +1-212-558-3866 baumgardenrj@sullcrom.com
Robert E. Buckholz, Jr. +1-212-558-3876 buckholrz@sullcrom.com
Catherine M. Clarkin +1-212-558-4175 clarkinc@sullcrom.com
Jay Clayton +1-212-558-3445 claytonwj@sullcrom.com
H. Rodgin Cohen +1-212-558-3534 cohenhr@sullcrom.com
Donald R. Crawshaw +1-212-558-4016 crawshawd@sullcrom.com
Robert W. Downes +1-212-558-4312 downesr@sullcrom.com
William G. Farrar +1-212-558-4940 farrarw@sullcrom.com
Matthew M. Friestedt +1-212-558-3370 friestedtms@sullcrom.com
Joseph B. Frumkin +1-212-558-4101 frumkinj@sullcrom.com
David B. Harms +1-212-558-3882 harmsd@sullcrom.com
Alexandra D. Korry +1-212-558-4370 korrya@sullcrom.com
Stephen M. Kotran +1-212-558-4963 kotrans@sullcrom.com
John P. Mead +1-212-558-3764 meadj@sullcrom.com
Scott D. Miller +1-212-558-3109 millersc@sullcrom.com
James C. Morphy +1-212-558-3988 morphij@sullcrom.com
Robert W. Reeder III +1-212-558-3755 reederr@sullcrom.com
Glen T. Schleyer +1-212-558-7284 schleeyerg@sullcrom.com
Max J. Schwartz +1-212-558-3936 schwartzma@sullcrom.com
Andrew D. Soussloff +1-212-558-3681 soussloffa@sullcrom.com
Christine A. Spillane +1-212-558-3067 spillanec@sullcrom.com
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