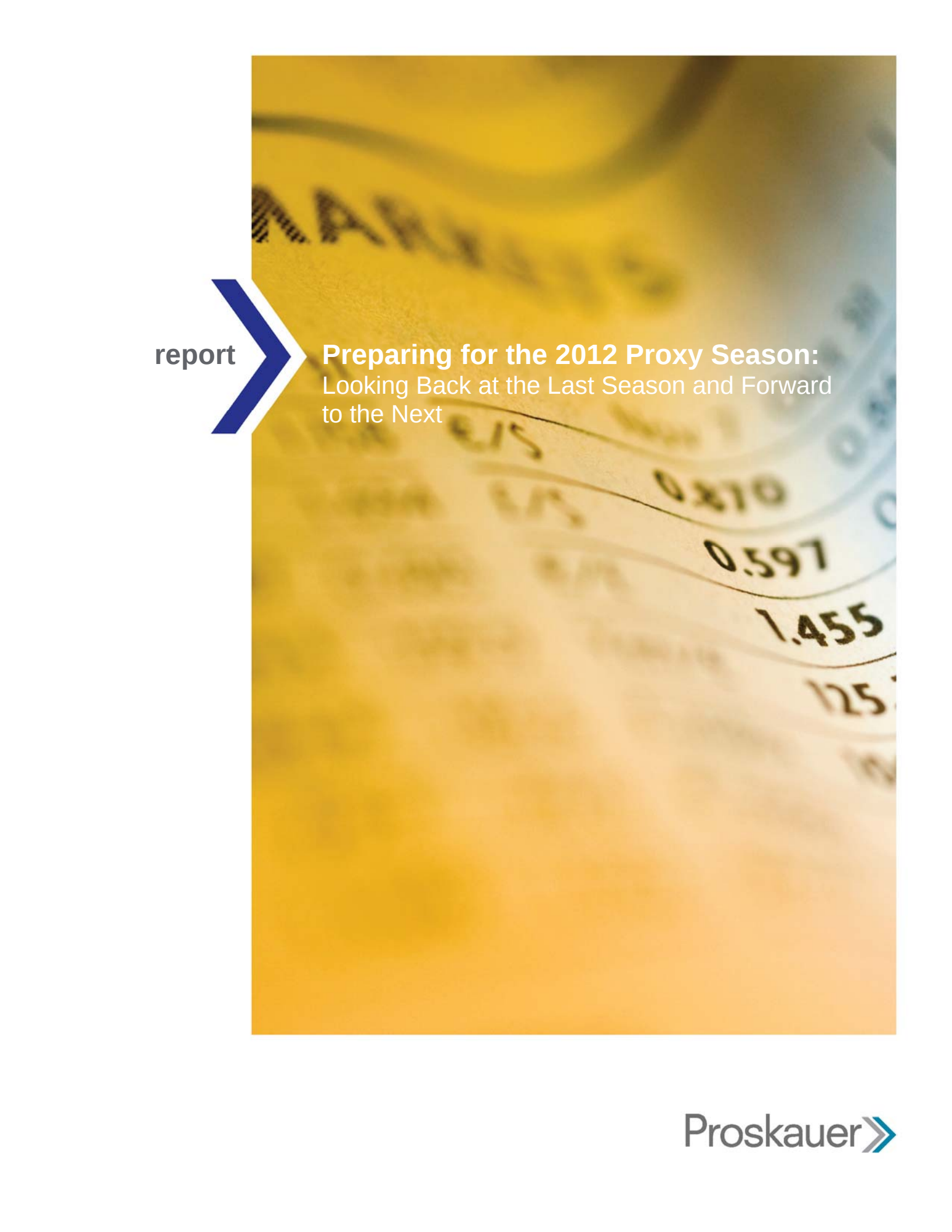




report

Preparing for the 2012 Proxy Season: Looking Back at the Last Season and Forward to the Next

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Summary of Key Points

Dodd-Frank say-on-pay votes had a big impact on the 2011 proxy season, and issuers under criticism for their pay practices should expect continued shareholder pressure on the say-on-pay front.

Consumer banks were the biggest target last season for proposals related to executive compensation and proposals concerning internal controls for loan modifications, securitization and foreclosures practices.

Majority voting proposals dominated the 2011 proxy season. As large-cap issuers agree to adopt board declassification and majority voting standards, look for shareholders to begin directing these proposals to mid-cap and small-cap companies in 2012.

Proposals concerning environmental and social policy issues increased in 2011 as compared to corporate governance and executive compensation proposals, but it appears that climate change and sustainability proposals have already peaked.

Proposals requesting reports on political contributions were prevalent among social policy proposals in 2011, and proponents are expected to continue pressing these proposals in greater numbers in 2012.

The SEC's proxy access rule was struck down, but the Commission's rule amendments permitting 14a-8 proposals for company-specific proxy access mechanisms is now effective. Such proposals must still be permitted by the state of the company's incorporation. We expect to see some private-ordering proposals this season if the gadflies pick up the cudgel, but we do not expect much institutional activity in the 2012 proxy season.

Background

Rule 14a-8 under the Securities and Exchange Act of 1934, as amended, regulates when a company must include a shareholder's proposal in the company's own proxy statement and when a company may exclude a proposal. The most active proponents of shareholder proposals are certain individuals, often referred to as corporate gadflies, some labor unions, certain religious groups and issue-advocacy funds.¹

A company that is the target of a shareholder proposal may want to avoid including the proposal in its proxy statement because the company may believe that it has little to do with the company or its governance, that it would violate state law if implemented, or that it lacks merit. If a company wishes to exclude a shareholder proposal, the company must request no-action relief from the Securities and Exchange Commission by persuading the Commission Staff that the proposal should be excluded under one or more of the designated grounds set forth in the rule.

Each proxy season, both issuers and shareholder proponents fight for space in corporate proxy statements to expound their positions and solicit shareholder votes. During the busy proxy season, lawyers at the SEC conduct multiple rounds of review for each no-action request and consider both the company's and the proponent's arguments for either including or excluding the proposal from the company's proxy materials. The SEC's internal deliberation and consideration is not made public. The SEC only makes public its final conclusion, which it posts on its website, in a brief no-action letter response.

¹ Proxy Monitor, Published by the Manhattan Institute, "New Database Reveals Shareholder Proposal Trends" available at <http://www.proxymonitor.org/Forms/Reports.aspx>.

The three most frequent grounds for exclusion comprise over 50% of the successful no-action exclusion requests. The most common ground for exclusion of a shareholder proposal is under Rule 14a-8(i)(7)—that the proposal relates to some aspect of the ordinary business operations of the company. Proposals are often excluded under Rule 14a-8(f) when the proponent fails to supply the required documentary support to evidence requisite ownership of the company's shares. In other instances, the proponent's proposal directly conflicts with a proposal on the same subject matter sponsored by the company and can thus be excluded under Rule 14a-8(i)(9).

In the appendix to this report, there is a chart that contains statistical information from last proxy season's no-action submissions and a chart summarizing the grounds for no-action relief, as well as an illustrative proxy season timeline for a company with a calendar year-end.

Trends From the 2011 Proxy Season

In 2011, the overall number of shareholder proposals submitted to the 100 largest American companies fell to their lowest level in the past three years.² In addition, of those proposals included in company proxy statements, the 2011 proxy season saw a general decline in the success of shareholder proposals. There are two reasons for these results. First, Section 951 of Dodd-Frank, which requires shareholder votes for "say-on-pay," eliminated the need — in the eyes of some proponents — for more specific proposals concerning executive compensation. Second, there was a relative increase in proposals devoted to corporate political spending, the environment and human rights, which do not garner majority shareholder support in most cases.³

Corporate governance proposals fell on a per company basis to below the 2008-2010 average.⁴ We believe that the decrease is attributable to the fact that shareholder proponents were busy preparing for say-on-pay advisory votes, the fact that many of the shareholder proposals in this category have already been adopted by targeted large-cap issuers, and shareholder's anticipation that universal proxy access would be implemented as a more direct means of addressing governance concerns. The last factor is addressed immediately below under "Litigation and SEC Actions in the 2011 Season."

There is evidence that say-on-pay has provided shareholder proponents additional leverage in seeking to impact compensation in the 2011 proxy season.⁵ This trend was partly influenced by the increase in advisory votes that have provided an incentive to make changes to executive pay practices in order to avoid an adverse result.⁶ Over 30% of the withdrawn no-action requests filed with the SEC indicated that they were withdrawn following dialogue between the issuer and the shareholder proponent. An additional 17% of no-action requests were withdrawn by the issuer when it decided to include or otherwise implement the shareholder proposal.

² Proxy Monitor, Published by the Manhattan Institute, "2011 Proxy Season Review Database Reveals Decline in Successful Shareholder Proposals," (2011) available at <http://www.proxymonitor.org/pdf/Finding7.pdf>.

³ Proxy Monitor, "New Database Reveals Shareholder Proposal Trends," (2011) available at <http://www.manhattan-institute.org/proxymonitor/Reports.htm>.

⁴ Ibid, at <http://www.proxymonitor.org/pdf/Finding7.pdf>.

⁵ Speech by SEC Commissioner Luis Aguilar, "An Inflection Point: The SEC and the Current Financial Reform Landscape" (Jun. 10, 2011) (observing that "say-on-pay is one catalyst to increasing shareholder engagement more broadly") available at <http://www.sec.gov/news/speech/2011/spch061011laa.htm>.

⁶ Preliminary 2011 U.S. Postseason Report, Institutional Shareholder Services (2011), available at <http://www.issgovernance.com/docs/2011USSeasonPreview>.

Litigation and SEC Actions in the 2011 Season

On July 22, 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated the SEC's universal shareholder "proxy access" rule.⁷ Rule 14a-11 would have required that a public company include in its proxy materials candidates for election to its board of directors who were nominated by a shareholder who continuously owned three percent of the voting power of the company's securities for three consecutive years.

SEC Chairman Mary Schapiro has made it clear that the agency will not appeal the federal court decision throwing out Rule 14a-11, but she has suggested the agency might rewrite the regulation.⁸ At this point, it is clear that issuers will not have to contend with mandatory proxy access for the 2012 season because any re-proposed rule will not be effective in time. We doubt that that SEC will have the time or inclination to take this on again anytime soon, especially given its heavy workload drafting rules mandated by Dodd-Frank.

In September, the SEC allowed its stay on the Rule 14a-8 amendments to expire, which it had initiated at the commencement of litigation over Rule 14a-11.⁹ The amendments to Rule 14a-8(i)(8) narrow a company's ability to exclude shareholder proposals relating to the election of directors. Amended Rule 14a-8(i)(8) would permit shareholders to propose "shareholder proxy access" mechanisms on a company-by-company basis.¹⁰

In Rule 14a-8 matters that resulted in litigation in the U.S. District Court for the Southern District of Texas, the Court has continued to agree with companies in applying a more stringent test in determining whether proponents have submitted adequate proof that they own the requisite number of shares to submit a proposal under the rule, particularly paragraphs 14a-8(b) and (f). Following on the *Apache* decision in 2010,¹¹ in 2011 KBR was able to successfully challenge the sufficiency of proof of ownership in the same Federal Court.¹² The dispute in both cases centered on asserting that the proponent was required to obtain a letter confirming his proof-of-ownership from the Depository Trust & Clearing Corp. (DTC), a nationwide clearing entity that holds shares on behalf of many U.S. investors and that a letter from his 'introducing broker' was not sufficient because the broker was not a DTC participant.¹³

In mid-October, the SEC Staff issued a new Staff Legal Bulletin to clarify how shareholders prove eligibility for submitting a proposal. The bulletin states that a shareholder must obtain a letter from a DTC-participating "record holder," reflecting a reversal of its earlier position. The Staff Legal Bulletin also addresses withdrawal procedures for multiple proponents and common errors that shareholders can avoid when submitting proof of ownership to companies, including a new suggested format for

⁷ *Business Roundtable, et al. v. SEC*, No. 10-1305 (D.C. Cir., filed Sep. 29, 2010) see also; <http://www.sec.gov/rules/other/2010/33-9149.pdf>.

⁸ "No Appeal on SEC Proxy Rule" (Sep. 08, 2011) available at http://online.wsj.com/article/SB10001424053111904900904576555253963782370.html?mod=WSJ_latestheadlines.

⁹ See the Proskauer client alert, "SEC Walks Away from Part of New Proxy Access, Faces Imminent Deadline on Remainder," (Sep. 09, 2011) for a more detailed discussion of the two rules, available at <http://www.proskauer.com/publications/client-alert/sec-walks-away-from-part-of-new-proxy-access-faces-imminent-deadline-on-remainder/>.

¹⁰ Facilitating Shareholder Director Nominations, Exchange Act Release No. 34-62764, (Sep. 16, 2010) available at <http://www.sec.gov/rules/final/2010/33-9136fr.pdf>.

¹¹ *Apache Corporation v. John Chevedden*, 696 F.Supp2d 723 (2010).

¹² *KBR v. John Chevedden*, No. H-11-0196 (S.D. Texas Apr. 29, 2011).

¹³ *Ibid.*

shareholders to follow.¹⁴ Lastly, the Staff addressed the question of revised proposals, indicating that a company must accept a revised proposal before the company's deadline for submission, as a revised proposal received in that timeframe will not be considered a separate proposal in violation of the one-proposal limitation under the rule.

Say-on-Pay Proposals

Section 951 of Dodd-Frank required public companies to provide their shareholders: an advisory vote on executive compensation ("say-on-pay" votes), an advisory vote on the frequency of future say-on-pay votes ("say-on-frequency" votes), and an advisory vote on compensations arrangements under some circumstances in connection with merger transactions ("golden parachute" arrangements).¹⁵

Section 951 temporarily exempted smaller reporting companies (those with less than \$75 million in public equity float) from the say-on-pay and say-on-frequency advisory vote requirements until annual meetings on or after January 21, 2013.¹⁶ Troubled Asset Relief Program (TARP) recipients must continue to comply with Rule 14a-20, which requires annual shareholder advisory votes on executive compensation.¹⁷ Companies with outstanding obligations under TARP are not required to conduct separate Dodd-Frank mandated say-on-pay votes and say-on-frequency votes until they have exited the TARP program. The recent quarterly report to Congress indicates that more than 500 of the 700 TARP banks have not repaid all outstanding TARP obligations.¹⁸

Say-on-pay votes were the defining characteristic of the 2011 proxy season. The mandated inclusion of advisory votes on executive compensation reduced shareholder proposals on executive compensation and shifted the relative balance of proposals toward social policy issues. Not quite as apparent has been the impact that say-on-pay advisory votes have had on compensation arrangements, with increasing instances where companies made adjustments in order to avoid a negative vote recommendation by ISS or another proxy advisor. Last season also saw the impact of proxy advisers grow as their recommendations concerning say-on-pay were a significant factor in whether a majority of shareholders voted for or against say-on-pay.¹⁹

While say-on-pay eliminated the perceived need for many of the shareholder proposals on executive compensation, it did not eliminate them all. In fact, shareholder proposals on executive compensation were still prevalent. The SEC did not routinely exclude these proposals as frequently as expected under either Rule 14a-8(i)(10) (substantially implemented by the say-on-pay proposal), or Rule 14a-8(i)(9) (conflicts with company's proposal on say-on-pay). For example, the SEC denied Navistar's no-action

¹⁴ SEC Staff Legal Bulletin No. 14F (Oct. 18, 2011) available at <http://www.sec.gov/interps/legal/cfslb14f.htm>.

¹⁵ "SEC Adopts Rules for Say-on-Pay and Golden Parachute Compensation as Required Under Dodd-Frank Act" (Jan. 25, 2011), available at <http://www.sec.gov/news/press/2011/2011-25.htm>.

¹⁶ Ibid.

¹⁷ Shareholder Approval of Executive Compensation of TARP Recipients, Release No. 34-61335 (Feb. 18, 2010) available at <http://www.sec.gov/rules/final/2010/34-61335.pdf>.

¹⁸ Office of the Special Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress (Jul. 28, 2011) available at http://www.sig tarp.gov/reports/congress/2011/July2011_Quarterly_Report_to_Congress.pdf.

¹⁹ "2011 Say on Pay Results: Russell 3000" report by Semler Brossy Consulting Group, LLC. (May 19, 2011), available at http://www.semlebrrossy.com/pages/pdf/SOP_Update.pdf.

exclusion request because the proposals focused on permitting shareholder votes for *future* executive severance agreements, for which the company did not already have a policy.²⁰

The two most frequent executive compensation proposals from last proxy season were requests to require senior executives to hold equity awards until after retirement (or for a substantial period after awards vested), and proposals to have shareholder approval of golden parachutes for executive officers.²¹ Thus, while Dodd-Frank say-on-pay and say-on-frequency diminished the overall number of executive compensation proposals last proxy season, it did not eliminate as many executive compensation proposals as had been anticipated. Proponents will continue to push executive compensation proposals despite the required votes and disclosures under Dodd-Frank.

Financial Services Industry and Executive Compensation

Last season, consumer banks and financial services continued to receive shareholder proposals focused on executive compensation and loan practices, and these issuers had the highest volume of denials of no-action relief.²²

Bank of America, for example, was unable to exclude a shareholder proposal submitted by the SEIU Master Trust (Service Employees International Union) that urged the board to amend its executive clawback policy and to determine whether to seek recoupment of bonuses and other incentive compensation paid to senior executive in the previous five years.²³ Goldman Sachs was also unable to exclude a shareholder proposal submitted by the Nathan Cummings Foundation, which requested a review and report on senior executive compensation policies (specifically asking whether perks, loans and retirement agreements are 'excessive').²⁴ The SEC noted that it views senior executive compensation as a significant policy issue and thus beyond the scope of the "ordinary business" exclusion under Rule 14a-8(i)(7).

Consumer banks also faced shareholder proposals directed at loan modifications, foreclosures and securitizations. Citigroup, for example, was unable to exclude a shareholder proposal submitted by the NYC Employees' Retirement System, which requested that Citigroup's board of directors have its audit committee conduct an independent review of internal controls related to loan modifications, foreclosures and securitizations.²⁵ The SEC once again noted its view that public debate concerning deficiencies in foreclosure and modification processes made these subjects significant policy matters outside the scope of exclusion as ordinary business under Rule 14a-8(i)(7).

²⁰ Navistar International Corp., SEC No-Action Letter (Jan. 4, 2011) available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/teamstersgeneralrecon010411-14a8.pdf>.

²¹ See e.g. Whirlpool Corp., SEC No-Action Letter (Jan. 28, 2011) (denying no-action relief for proposal to have shareholder approval of senior executive severance agreements). See also; Intel Corp., SEC No-Action Letter (Mar. 14, 2011) (denying no-action relief for proposal to change holding period for senior executive incentive plans).

²² Forty-five requests for no-action relief by consumer banks and financial services institutions, only twenty-five (56%) received the requested relief. This is well below the average of 71% for all relief requested.

²³ Bank of America Corp., SEC No-Action Letter (Mar. 8, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/seiумaster030811-14a8.pdf>.

²⁴ The Goldman Sachs Group Inc., SEC No-Action Letter (Mar. 3, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/nathancummings030211-14a8.pdf>.

²⁵ Citigroup Inc., SEC No-Action Letter (Mar. 2, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/nycemployees030211-14a8.pdf>.

Majority Voting

Proposals for majority voting in uncontested board elections have been common since at least the 2006 proxy season. These proposals fared well in the 2011 proxy season, winning majority approval at 22 companies.²⁶ In addition, many proposals on this topic were withdrawn after companies agreed to modify their voting standard voluntarily, or after management proposals on majority voting were put forth.

The renewed interest in majority voting follows Congress' elimination of a majority voting requirement from Dodd-Frank, prompting activist shareholders to submit more proposals on this topic than any other in 2011.²⁷ Both the Florida and California pension systems used aggressive letter writing campaigns to influence reform, while the Council of Institutional Investors has urged companies to adopt majority voting. For example, CalPERS targeted 58 companies with a request to voluntarily adopt simple majority voting procedures.²⁸ CalPERS successfully proposed a majority vote resolution at Apple last proxy season, and it has estimated that 80% of the S&P 500 and nearly 60% of the Russell 1000 have adopted some form of majority voting.²⁹ Despite the widespread acceptance of majority voting among large-cap issuers, investors appear to remain focused on the issue and are expected to seek to push for mid-cap and small-cap companies to adopt these practices, according to reports from ISS and recent activity by the Council of Institutional Investors.³⁰

Proponents also continue to press large cap issuers that have not adopted some form of majority voting, or that have adopted majority voting, but not in a formal by-law amendment and/or without a "director resignation policy." A director resignation policy is a policy that requires a director who has not received majority support to resign within a specified time period. Under state laws permitting a director to remain in office until a successor has been named, many such directors reportedly have continued to serve out their terms.

Shareholder Written Consent

Proposals that seek to permit shareholders to act by written consent in lieu of a physical meeting have further increased from the 2010 proxy season, when they reappeared after several years in hiatus. Interestingly, every proposal on this topic that was presented to a Fortune 100 company this past proxy season was from one of three specific individual proponents.³¹ Written consent proposals averaged 48%

²⁶ Preliminary 2011 U.S. Postseason Report, Institutional Shareholder Services (2011), available at <http://www.issgovernance.com/docs/2011USSeasonPreview>.

²⁷ Ibid.

²⁸ Miranda Ward, "CalPERS Warns that Apple Tempts Downfall," (Feb. 23, 2011) top1000funds.com available at <http://www.top1000funds.com/news/2011/02/23/calpers-warns-that-apple-tempts-downfall/>.

²⁹ See, "CalPERS seeks Majority Vote for Apple Director Elections," Press Release (Feb. 03, 2011) see also; "Apple Loses Investor Vote" Wall Street Journal (Feb. 24, 2011) available at <http://onespot.wsj.com/small-business/2011/02/24/8661f/apple-loses-investor-vote>.

³⁰ Letter to the American Bar Association of Business Law Section's Committee on Corporate Laws on behalf of the Council of Institutional Investors, (Aug. 11, 2011) available at [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2011/August%202011%20ABA%20Letter%20\(final\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2011/August%202011%20ABA%20Letter%20(final).pdf).

³¹ "The Top Shareholder Proposals of 2011 Proxy Season", Laura Finn, (quoting James R. Copland director Center for Legal Policy at the Manhattan Institute for Policy Research) (project manager of ProxyMonitor.org) http://www.boardmember.com/Article_Details.aspx?id=6347.

approval at the 32 companies where they were presented.³² Several issuers have stated that they will now consider changes to their bylaws in response to shareholder endorsement of action by written consent. The surge in proposals on this subject may have been driven, in part, by the fact that it is virtually impossible for companies to exclude them under Rule 14a-8.

The Environment and Social Policy

The SEC continues to allow certain types of proposals on environmental and social issues into proxy statements based on its view that they are socially or politically “significant.” Last proxy season included more proposals to report on the environmental impact of hydraulic fracturing, or “fracking,” which saw average shareholder support move up from just over 30% in 2010 to over 40% in 2011, likely due to increased press coverage of the subject.³³ Hydraulic fracturing is a process that involves pumping pressurized fluid or other substance (often a mixture of water, chemicals and/or sand) underground to free difficult-to-reach gas (coal seam, natural gas or petroleum).

A noted “new” social policy proposal of last proxy season concerned reporting on, and seeking reductions in, the risk of workplace accidents. This campaign was spearheaded by the AFL-CIO and largely targeted oil and gas companies.³⁴ These shareholder proposals represent an example of a very narrowly tailored and targeted campaign focused on a social policy issue of concern to the members of the AFL-CIO. The SEC has not recognized workplace safety as a significant policy issue, and several issuers were successfully able to argue for the exclusion of these proposals.³⁵

Political Contributions and Lobbying

There was a notable increase in political expenditure and lobbying proposals this year as a result of the U.S. Supreme Court’s *Citizens United* decision.³⁶ The decision was both contentious in that it allowed for-profit organizations to fund unlimited broadcast electioneering communications, and widely publicized so as to arouse shareholder interest. Many of the withdrawn shareholder proposals from the 2011 season were requests for reports on political expenditures after an issuer made its contributions public, or made it known that it did not make any political contributions.³⁷

While the Center for Political Accountability has been requesting proposals for reports on corporate political spending and related policies for the last several proxy seasons, new proposal requests by AFSCME (American Federation of State, Country & Municipal Employees) have expanded to include “grassroots lobbying,” and support for trade associations and other organizations that participate in the

³² Preliminary 2011 U.S. Postseason Report, Institutional Shareholder Services (2011), available at <http://www.issgovernance.com/docs/2011USSeasonPreview>.

³³ Ibid.

³⁴ See e.g., ConocoPhillips, SEC No-Action Letter (Jan. 31, 2011) (denied no-action relief because company practices and policies did not compare favorably with proposal) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/aflcio013111-14a8.pdf>.

³⁵ See e.g., Exxon Mobil Corp., SEC No-Action Letter (Mar. 3, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/aflcioreserve031711-14a8.pdf>.

³⁶ *Citizens United v. Federal Election Commission*, 558 U.S. 08-205 (2010).

³⁷ See UPS No-Action Letter (Jan. 1, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/walden2assetmanagement1711-14a8.pdf>.

political process. These new proposal types only averaged 24% support at the five companies where they made it into the proxy materials last season.³⁸

Looking Ahead to the 2012 Proxy Season

Pay Practices

Shareholders last year largely favored annual frequency for advisory votes on executive pay, primarily driven by ISS's "one-size-fits-all" policy to recommend annual say-on-frequency advisory votes in all cases. Given that 2012 is only the second proxy season since the Dodd-Frank say-on-pay rules have taken effect, shareholders will be examining closely how pay practices at some companies have changed after the advisory votes. Those companies with failed advisory votes (only about 2%), those that are under fire this year for pay practices and/or performance, and those that received low levels of majority support will likely face increased shareholder scrutiny in the 2012 proxy season. Companies should take advantage of the now-required disclosure in the compensation discussion and analysis section of their proxy statements to show how they addressed the say-on-pay votes, and use this disclosure as an opportunity to anticipate and respond to activist shareholder criticism of pay practices.

A recent Towers Watson survey reinforced the notion that say-on-pay and say-on-frequency advisory votes have increased the amount of time issuers spend on both executive pay matters and dialogue with institutional shareholders, and will correspondingly increase the amount of time issuers devote to the upcoming proxy season. The survey indicated that 71% of companies that received significant opposition to their programs (i.e., less than 80% shareholder support and at least one negative vote recommendation) plan to devote more time and effort to this issue in the 2012 proxy season.³⁹ Companies that seek to impact shareholder approval of say-on-pay proposals have taken a variety of measures, which range from reaching out to shareholders directly (56%) to communicating with proxy advisors (53%) or hiring a proxy solicitor (40%).⁴⁰

As noted above, Dodd-Frank say-on-pay and say-on-frequency advisory votes have not eliminated shareholder proposals on specific aspects of executive compensation that fall outside what is disclosed pursuant to Item 402 of Regulation S-K. Specifically, issuers should expect more executive compensation proposals that ask for shareholder votes on such matters as approval of severance payments to executives, and sustainability metrics for executive compensation. In many cases, the SEC Staff will not grant no-action relief permitting companies to exclude shareholder resolutions that seek votes on future policies and practices related to executive compensation (where no such policies currently exist or existing policies do not compare favorably with the proposal).

The SEC Staff has also confirmed that it considers executive compensation a significant policy issue and therefore shareholder proposals concerning executive compensation cannot be excluded under Rule 14a-8(i)(7) as ordinary business. This means that even with Dodd-Frank required disclosures, companies should expect to see shareholders continue to press for board reports on, and committee reviews of, almost every aspect of executive compensation, including perquisites. By way of example, last proxy season, Bank of America was unable to exclude a proposal that sought to deny senior executives the ability to be compensated for a financial loss on their homes. The SEC concluded the proposal focused

³⁸ Preliminary 2011 U.S. Postseason Report, Institutional Shareholder Services (2011), available at <http://www.issgovernance.com/docs/2011USSSeasonPreview>.

³⁹ "Inaugural Say-on-Pay Proxy Season Brings Few Problems For Most Companies, Although Many Plan Changes for 2012, Towers Watson Survey Finds," (Jul. 28, 2011) available at <http://www.towerswatson.com/united-states/press/5080>.

⁴⁰ Ibid.

on the significant policy issue of executive compensation (and did not seek to micromanage the company).⁴¹

As provided in its rules, the SEC Staff will not concur in the exclusion of shareholder proposals that recommend a different say-on-frequency choice, unless in the most recent shareholder vote on frequency, a single frequency choice (i.e., one, two or three years) received the support of a majority of votes cast and the issuer adopted a policy consistent with that choice.⁴² The impact of this new note to Rule 14a-8(i)(10) is that in the absence of majority support for any one of the frequency choices, the issuer will not be permitted to exclude a shareholder proposal for a different vote frequency.

Majority Voting and Board Declassification

The success of majority voting proposals last season and the stalled efforts of the SEC to implement universal proxy access rules indicate that the 2012 proxy season should see shareholders continue to devote time and attention to challenging plurality voting standards in favor of simple majority voting standards in uncontested director elections. For example, a majority voting proposal submitted by a frequent individual shareholder proponent was supported by a majority of votes cast at Prudential in the 2011 proxy season.⁴³ It is anticipated that the 2012 proxy season will see shareholders submit proposals for majority voting, likely focusing on issuers where the vote was close last season, and begin to extend the campaign to mid-cap and small-cap issuers.

Board declassification proposals in the 2011 proxy season were spearheaded by the efforts of the American Corporate Governance Institute, which worked with institutional investors to submit these proposals. ACGI also reports commitments from six additional S&P 500 companies, which are expected to submit management-sponsored declassification proposals for shareholder approval in 2012.⁴⁴ The overall number of board declassification proposals dropped. Data from Governance Metrics International shows that only 33% of S&P 500 companies still have classified boards.⁴⁵

Activist shareholder sentiment in favor of declassified boards combined with the continued support among academic studies suggests that classified boards will be targets for shareholder proposals again in 2012.⁴⁶ In particular, we expect that shareholders will look to close the so-called “small-cap gap.” This gap is evidenced by the fact that while more than 75% of S&P 500 companies have adopted a majority voting standard, just over 40% of the S&P 1500 have adopted a majority voting standard.⁴⁷ Proxy

⁴¹ Bank of America Corp., SEC No-Action Letter (Mar. 4, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/ctwinvestment030411-14a8.pdf>.

⁴² Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Release No. 34-63768 (Apr 4, 2011) available at <http://www.sec.gov/rules/final/2010/34-61335.pdf>.

⁴³ See Prudential Financial Inc., No-Action Letter (Feb. 18, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/johnchevedden021811-14a8.1.pdf>.

⁴⁴ The Harvard Law School Forum on Corporate Governance and Financial Regulation, “Moving Twenty-Two S&P 500 Companies towards Board Declassification” (Jun. 28, 2011) available at <http://blogs.law.harvard.edu/corpgov/2011/06/28/moving-twenty-two-sp-500-companies-towards-board-declassification/>.

⁴⁵ Governance Metrics International’s Board Analyst database indicates that approximately 33% of S&P 500 companies have a classified board, the lowest proportion since the firm began tracking this data point.

⁴⁶ See, *Air Products and Chemicals, Inc. v. Airgas, Inc.*, C.A. No. 5249 (Del. Ch. Feb. 15, 2011), see also study suggesting classified boards as value-reducing for shareholders (Bebchuk, Cohen, and Wang, 2011).

⁴⁷ “Corporate Governance: The Latest Trends and Results from the 2011 Proxy Season,” Deloitte Dbriefs (Jul. 6, 2011) available at http://www.deloitte.com/view/en_US/us/Insights/Browse-by-Content-Type/dbriefs-webcasts/ca48791d1de80310VqnVCM1000001956f00aRCRD.htm.

advisors, academics and shareholder activist groups are eager to close this gap and spread the adoption of majority vote standards and annual director elections. Thus, we expect shareholder proposals on these issues to continue for the 2012 proxy season.

Environmental and Social Policy Proposals

Environmental and sustainability policy proposals are still expected to be prominent in the 2012 proxy season. Proponents with the As You Sow foundation have promised more proposals on recycling, and there has been an increasing prominence of environmental and social proposals from the New York State Common Retirement Fund and the New York City pension funds.⁴⁸ Meanwhile, a new study from Ernst & Young has found that environmental proposals have garnered increasing voting support amongst shareholders.⁴⁹

For oil and gas companies, last season saw increasing public focus on “fracking,” discussed above, and correspondingly, more proposals directed at this practice. The SEC has recently requested detailed information from oil and gas companies concerning their use of fracking methods for resource extraction.⁵⁰ The SEC has not formulated any rules requiring mandatory disclosure on fracking, but has only requested information confidentially. This information may form the basis of interpretive guidance or new rule proposals that require or urge aspects of the practice to be publicly disclosed in some circumstances. Some oil and gas companies have voluntarily determined to make additional public disclosures in anticipation of shareholder, state, regulatory and public concerns.⁵¹

While the threshold of support for environmental proposals is still relatively low, it appears that shareholders are showing an increasing willingness to vote in favor of these types of proposals. ISS research indicates that a decade ago average support for environmental and social policy proposals was only at around 8%, but in last proxy season it reached 20%.⁵²

Shareholder proposals seeking disclosure of corporate expenditures for political activities will continue to be a major focus in the area of social policy proposals. For example, ISS reports that Walden Asset Management plans to continue pressing companies that serve on the board of the U.S. Chamber of Commerce on this issue, citing the Chamber’s positions on climate change legislation.

Recently, a group of corporate and securities law academics submitted a formal rulemaking petition to the SEC.⁵³ The group requested that the SEC initiate a rulemaking project to require public disclosure of corporate political spending. The petition lacks specifics, but has been well publicized and therefore may add incrementally to the pressure on issuers that receive proposals on the subject.

⁴⁸ Proxy Monitor “Environmental Issues, Political Contributions Key Focus in Proxy Process” (2011) available at <http://www.proxymonitor.org/Forms/Finding2.aspx>.

⁴⁹ Ernst & Young, “Shareholders press boards on social and environmental risks” (May 20, 2011) available at [http://www.ey.com/Publication/vwLUAssets/CCaSS_social_environmental_risks/\\$FILE/CCaSS_social_environmental_risks.pdf](http://www.ey.com/Publication/vwLUAssets/CCaSS_social_environmental_risks/$FILE/CCaSS_social_environmental_risks.pdf).

⁵⁰ Deborah Solomon, “SEC Bears Down on Fracking”, Wall Street Journal, Aug. 25 2011, available at http://online.wsj.com/article/SB10001424053111904009304576528484179638702.html?mod=WSJ_hps_sections_business.

⁵¹ See e.g., <http://fracfocus.org/>.

⁵² ISS Preliminary 2011 U.S. Postseason Report

⁵³ Committee on Disclosure of Corporate Political Spending Petition for Rulemaking (Aug. 3, 2011) available at <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf>.

Proposals to report on political contributions and lobbying can be difficult to avoid simply by implementing disclosure and other measures designed to meet the demands of the proponents. For instance, the SEC was unwilling to exclude a proposal on political expenditures at Exxon even though it had already publicly disclosed information about political contributions and lobbying on its website.⁵⁴ The SEC agreed with the shareholder proponents that the website disclosure was inadequate and denied the no-action exclusion request.

The SEC has consistently distinguished between shareholder proposals that are excludable because they relate to lobbying or political activities that support specific business operations, and those proposals that relate to general political activities. Those shareholder proposals that focus primarily on specific lobbying activities are excludable under Rule 14a-8(i)(7), while those that focus on general political activities are not excludable.⁵⁵

Proxy Access

Depending on the mailing date of last year's proxy materials, shareholders at some companies may still have time to submit proxy access proposals under amended Rule 14a-8. Rule 14a-8(e)(2) requires shareholder proposals to be received not less than 120 days before the anniversary date of the mailing of the previous year's proxy statement (or within a reasonable time before a company begins printing proxy materials if the meeting date has been moved by more than 30 days).

While we expect that some corporate gadflies may submit proposals this proxy season concerning director nomination procedures, most activist institutional investors will likely take more time to prepare, analyze, understand and then orchestrate a campaign on proxy access proposals. Given the late date upon which the stay was lifted, and in consideration of the 120-day requirement under the Rule, it is unlikely that institutional investors will submit more than a handful of proxy access proposals over the course of the 2012 proxy season.

How Issuers Can Prepare

The first thing issuers can do to prepare for the upcoming proxy season is to be ready to react in advance of receiving a proposal, such as a new "proxy access" shareholder proposal. We recommend that you review the proposals and trends from last season. It is important to review the shareholder proposals that were submitted not only to the individual issuer last season, but those submitted more generally in the issuers' industry. Many times proponents will test run their proposals and then seek to reintroduce them in the next proxy season after various refinements. Given the sophistication of many activist shareholders (notably corporate gadflies, unions and social policy-driven institutional shareholders) and their ability to orchestrate mass campaigns, issuers should anticipate becoming targets if their practices or policies do not compare favorably with the agendas of these activist shareholders.

⁵⁴ See "Political Contributions and Lobbying" at Exxon Mobil.com, available at http://www.exxonmobil.com/Corporate/about_issues_political_data.aspx. See also; Exxon Mobil Corp., SEC No-Action Letter, (Mar. 22, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/laborersnational032211-14a8.pdf>.

⁵⁵ Compare Pepsi Co., SEC No-Action Letter (Mar. 03, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/nationallegal030311-14a8.pdf> with Bank of America, SEC No-Action Letter (Mar. 07, 2011) available at <http://sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/afscmeemployees030711-14a8.pdf>.

The second way to be prepared is to be on alert for last-minute changes at the SEC in its interpretations in this area. It is no secret that the SEC is overburdened with Dodd-Frank mandated rules. There have been numerous delays in implementation and we expect that there will continue to be delays and frustration as budgetary and legal challenges persist. As a departure from past practice, the SEC has made material changes to its rules and interpretations both close to the beginning of the proxy season as well as throughout the season. An issuer must be alert to SEC rulemaking and ready to respond to shareholder proposals that fit under the latest rules promulgated by the SEC.

Third, issuers must recognize the trend of increasing and early engagement with shareholders. The Dodd-Frank advisory votes and the SEC's recent commentary on proxy access show that the goal of many new regulations is to increase communication between shareholders and corporate issuers. The fact that last season saw an increasing number of withdrawn shareholder proposals in response to dialogue between the issuer and shareholder further supports this trend. If the bar is moving, a particular company's practices may inadvertently fall behind the average or consensus practice. Once the deadline for submitting proposals under Rule 14a-8 has passed, companies should consider reaching out to their institutional shareholders if they have "raised their hands" in the 14-8 process. An early engagement with large institutional shareholders can help companies gauge sentiment and help frame the issues in a light that is more favorable to the companies.

The fourth way to prepare is to understand the utility and purpose of the SEC no-action exclusion process. The simple fact is that the no-action relief process works (71% of requests were granted last season) and is a useful tool in excluding shareholder proposals that lack merit or that are otherwise defective. However, the no-action process only works when the issuer uses the right arguments. Last season, for example, the SEC rejected many technical challenges under rules 14a-8(b) and (f), so that issuers that relied solely on these grounds were not successful. Focusing time and energy on one or two technical arguments alone (and not considering other substantive grounds or engaging the shareholder directly) may not be the issuer's best Rule 14a-8 strategy. Using the right grounds and understanding the SEC's goal in the no-action process can make all the difference in successful exclusion of a shareholder proposal.

Statistics For Division of Corporation Finance No-Action Letters Issued Under Rule 14a-8

	Number:		
Total No-Action Requests:	316		(Aug '10-July '11)
			Percent Success:
No-Action Granted:	192		71% (vs. Denial)
No-Action Denied:	79		29% (vs. Grant)
Other Dispositions:			
Moot Because Withdrawn:	42		16%
Moot b/c dialogue:	13		31%
Moot b/c implemented:	7		17%
Reconsider Requested:	26		1%
Individual Proponent Proposals:	75		33%
Financial Svcs / Banks:	45		56%
Successful No-Action Grounds:			
14a-8(i)(7)	57		30%
14a-8(f)	28		15%
14a-8(i)(9)	24		13%
14a-8(i)(10)	22		12%
14a-8(i)(11)	15		8%
14a-8(i)(3)	9		5%

Illustrative 2012 Proxy Season Table (Calendar Year Companies)

Date	Action	Notes
September – November 2011	SEC rulemaking and preparation for engagement with shareholders.	Delays and unexpected rulemaking from the SEC may impact what to expect in the upcoming proxy season. Watch for the release on amendments to Rule 14a-8 and expected rules under Dodd-Frank sections 953 and 954.
November - December 2011	Deadline to notify proponents of defects in their proposals.	Rule 14a-8(f) requires that notification of defects must occur with 14 days of the receipt of the proposal. A company need not provide you such notice of a deficiency if the deficiency cannot be remedied.
December 2011	The deadline for shareholder proposals to be submitted for inclusion in an issuers proxy materials.	Rule 14a-8(e)(2) requires shareholder proposals to be received not less than 120 days before the anniversary date of the mailing of the previous year's proxy statement release (or within a reasonable time before a company begins printing proxy materials if the meeting date has been moved by more than 30 days).
December 2011	Shareholder proponents' response to notice of deficiency by the issuer.	Rule 14a-8(f) requires that the response be postmarked, or transmitted electronically, no later than 14 days from the date the shareholder received the company's notification.
December - January 2012	Determine a course of action and prepare to respond.	Engage in discussions with governance committee, investor relations and other relevant committees. Consider enlisting outside assistance.
December - January 2012	Deadline for filing SEC no-action requests.	Rule 14a-8(j) requires an issuer who intends to try and exclude a shareholder proposal to file a no-action request no later than 80 days before filing a definitive proxy statement.
February 2012	Negotiate, discuss and prepare shareholder communications outreach strategies.	Open a dialogue with shareholder proponents. Use strategies to engage proponents and seek to have them withdraw their proposals. Prepare solicitation materials and prepare opposition or support statements. Prepare to respond to proxy adviser recommendations and models.

March 2012	File and provide shareholder proponent company opposition materials.	Rule 14a-8(m)(3)(i) and (ii) require company to provide a copy of the opposition statement to shareholder proponents 30 days before filing definitive proxy statement (or no later than 5 days after receiving revised proposal after no-action request).
April 2012	File definitive proxy statement.	SEC Form DEF 14A is the most commonly used form and companies should be sure to include the required disclosures.
April – May 2012	Continue shareholder outreach.	SEC Form DEFA14A gives issuers the opportunity to file additional proxy soliciting materials.
May 2012	Annual meeting.	Adherence to an effective script, rules of conduct and investor presentation.

14a-8 Grounds for No-Action Relief

Rule	Grounds	Notes
14a-8(i)(1)	If the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization	Proponents often phrase their proposals as recommendations or requests to take action as far as proper under applicable state laws.
14a-8 (i)(2)	If the proposal would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject	Example: last proxy season a proposal to waive the "fraud-on-the-market" presumption of reliance under Rule 10b-5 was excluded because implementation would cause the company to violate federal securities law.
14a-8(i)(3)	If the proposal or supporting statement is contrary to any of the SEC's proxy rules, including Rule 14a-9, which prohibits materially false or misleading statements in proxy soliciting materials	Proposals which are inherently vague and indefinite so that neither the shareholder nor the issuer could properly determine what effect the proposal might have.
14a-8(i)(4)	If the proposal relates to the redress of a personal claim or grievance against the company or any other person, or if it is designed to result in a benefit to you, or to further a personal interest, which is not shared by the other shareholders at large	These proposals are often from former employees or unsuccessful litigants against the company.
14a-8(i)(5)	If the proposal relates to operations which account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business	The SEC is very skeptical of arguments based on this ground and frequently permits proposals of social or political significance despite this rule.
14a-8(i)(6)	If the company would lack the power or authority to implement the proposal	Very infrequently granted relief on this ground since proponents can revise proposals.
14a-8(i)(7)	If the proposal deals with a matter relating to the company's ordinary business operations	Issuers often argue that proposals micro-manage and interfere with day-to-day company business.
14a-8(i)(8)	If the proposal relates 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	Lifting the voluntary stay on proxy access proposals under this rule could have a big impact this proxy season. Implementation of a proxy access rule is expected to eventually narrow this ground for exclusion.
14a-8(i)(9)	If the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting	Issuers can use this rule to put forth their own proposals and exclude shareholder proposals on the same matter.

14a-8(i)(10)	If the company has already substantially implemented the proposal	Substantially implemented is decided by the SEC Staff on a case-by-case basis. They look to see if policies and practices compare favorably with the requests of the proposal.
14a-8(i)(11)	If the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting	The first shareholder proposal submitted on the subject is the first to be included and subsequent proposals on the same matter can be excluded on this ground.
14a-8(i)(12)	If the proposal deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company's proxy materials within the preceding 5 calendar years	The minimum thresholds for exclusion under this rule are low at 3%, 6% or 10% depending on how recently the proposal was presented in the past 5 years.
14a-8(i)(13)	If the proposal relates to specific amounts of cash or stock dividends	Proposals excluded on this ground are rare.

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