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Recent Developments and Trends in Rule 14a-8 Shareholder Proposals

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Presentation Agenda

- Shareholder proposals 101
- Shareholder proposals submitted in 2013
- Voting support levels for shareholder proposals in 2013
- Proponent trends
- Target trends
- Shareholder engagement
- Effect of revised ISS Policy on board responsiveness
- Rule 14a-8 procedural issues
- Trends in 2013 SEC no-action letters
- Litigation related to Rule 14a-8
- Additional SEC guidance over the past year
- Does Rule 14a-8 need to be modernized?
- What to expect in 2014

Shareholder Proposals 101

- Rule 14a-8
 - Eligibility requirements
 - Submission deadline
- Proponents
- Targets
- Types of shareholder proposals
 - Corporate governance
 - Executive compensation
 - Social and policy
- SEC no-action letter process for excluding proposals
- Excluding on procedural / eligibility grounds
- Excluding on substantive grounds

Shareholder Proposals Submitted During 2013

- **Most frequently submitted proposals**
 - Independent Board Chair (55)
 - Report on lobbying payments and policy (36)
 - Stock retention / holding period for executives (35)
 - Political contributions disclosure (31)
 - Majority voting for the election of directors (29)
 - Declassification of Board (28)
 - Pro-rata vesting of equity awards (27)
 - Right to act by written consent (25)
 - Reduce supermajority vote requirement (20)
 - Report on sustainability (13)

Shareholder Proposals Submitted During 2013

- Number of proposals submitted in 2013 compared to 2012
- Number of proposals submitted in 2013 compared to pre-Dodd Frank years
 - Below pre-Dodd Frank years since mandated “say on pay” management proposals have eliminated the need for shareholders to make similar proposals
- 2013 mix of proposals (corporate governance, executive compensation, social and policy)
 - Mix is very similar to 2012
- How has the increased prevalence of majority voting in the election of directors and annually elected directors affected the utility of shareholder proposals as a tool to influence boards?

Shareholder Proposals Submitted During 2013

▪ **Corporate Governance Proposals**

- Board declassification
 - Many proposals brought by public employee pension funds in an effort overseen by Harvard Law School's Professor Lucian Bebchuk and his Shareholder Rights Project
 - Average support slightly below 2012 at 78.7%
 - ISS consistent in recommending FOR the proposal
- Majority voting for the election of directors
 - Smaller companies are being targeted
 - Active negotiations with proponents behind the scenes
 - Average support slightly below 2012 at 56.1%
 - ISS consistent in recommending FOR the proposal

Shareholder Proposals Submitted During 2013

▪ **Corporate Governance Proposals**

▪ Written consent

- All written consent proposals were at companies that did not allow actions by written consent
- Companies adopting their own written consent proposal to be able to exclude on basis on Rule 14a-8(i)(9)
 - More than half of the no-action letters seek to exclude on basis that it conflicts with management's proposal.
 - ISS generally likely to support a management proposal for written consent even if it contains numerous restrictions
- Average support for shareholder sponsored written consent proposal below 2012 at 41.5% (45% in 2012)
- At least 3 instances in 2013 of ISS recommending AGAINST a shareholder proposal for written consent

Shareholder Proposals Submitted During 2013

- **Corporate Governance Proposals**

- Special meetings

- Allow shareholders to call special meetings
 - Average support level of 41% down from 53% in 2012

- Lower threshold for shareholders to call special meetings

- Average support level of 33% up from 31% in 2012

- Shareholder proposals to just lower the ownership threshold do not receive as much support as proposals to allow shareholders to call a special meeting

Shareholder Proposals Submitted During 2013

▪ **Corporate Governance Proposals**

▪ Separation of Chairman and CEO

- Most commonly introduced corporate governance proposal in 2013
- Numerous instances of ISS recommending AGAINST
- Strict criteria for ISS recommendation AGAINST
- Average support below 2012 at 29.1%

▪ Repeal supermajority vote requirements

- Average support about same as 2012 at 65.4%

▪ Cumulative voting

- A favorite of Evelyn Davis who did not submit any proposals in 2013
- Only one proposal received within the Fortune 250; less than 30% support level

▪ Elimination of dual-class stock structures

- e.g., Ford, Google, Comcast, UPS, Dreamworks Animation, etc.

Shareholder Proposals Submitted During 2013

▪ Proxy access

- 11 proxy access proposals in 2013
- Drafting errors corrected to reduce vulnerability to no-action exclusion
- Majority support at 3 companies (compared to 2 in 2012)
- No surge in proxy access proposals in 2013
 - In 2012, shareholder-sponsored proxy access proposals won majority support at two U.S. companies— Nabors Industries and Chesapeake Energy
- Average support at 32%.
 - Proxy access proposal at Disney received just under 40% support
- Activist hedge funds have not embraced proxy access
- Has private ordering of proxy access “movement” lost momentum?
- Is a revived Rule 14a-11 unlikely?

Shareholder Proposals Submitted During 2013

▪ **Executive Compensation Proposals**

- Tripartite / triennial “say on pay” proposals from the United Brotherhood of Carpenters
- Stock retention / holding period for executives
- Pro-rata vesting of equity awards
- Equity compensation plan rules
- Golden parachutes
- Shareholder approval of extraordinary retirement benefits
- No accelerated vesting of equity awards upon CIC
- Report on ratio CEO pay/lowest paid worker

Shareholder Proposals Submitted During 2013

- **Social and policy issues**

- Report on lobbying payments and policy (*most introduced social / political proposal*)
- Political contributions disclosure
 - *Qualcomm* lawsuit initiated by the NY State Common Retirement Fund, using DE law that gives shareholders right to inspect some company books and records, to force greater disclosure of corporate political spending
- Report on sustainability
- Other environmental issues
- Human rights
- Employment rights
- Animal rights

Voting Support Levels for Shareholder Proposals in 2013

- Fewer shareholder proposals receiving majority support this proxy season
 - only 7% received majority support
- Lower support levels may be due to a shift in the types of proposals introduced in 2013
 - increased share of proposals relating to social or political issues (42%)
- Proposals most likely to receive majority support in 2013:
 - board declassification (average support – 78.7%)
 - majority voting (average support – 56.1%)
- Relatively low support levels for environmental /social proposals
 - political spending / lobbying proposals (average support - 29%)
- Independent chair proposals were popular (55 proposals submitted) but not highly supported (average support – 29.1%)

Proponent Trends

- Retail investors accounted for 25% of proposals
- Religious organizations, social investors and public policy groups accounted for 25% of proposals
 - Increase in 2013 in religious institutions' activity—with the share of proposals introduced by such groups up from 3 percent to 5 percent
- Labor-affiliated pension funds accounted for 32% of all proposals
- Increase in 2013 in the number of shareholder proposals introduced by state/ local pension funds which introduced more proposals than private-sector pension funds
- Continuing lack of significant interest by institutional investors without social or policy affiliation to make use of shareholder proposals
- Activist hedge funds make little use of Rule 14a-8 shareholder proposals

Target Trends

- As in previous years, a substantial majority of shareholder proposals were received by large cap companies
- Which companies received the most proposals in 2013?
- Can you predict which companies will be targeted for which proposals?
 - Targeted based on inclusion in a specific stock index?
 - Targeted based on market cap?
- Are small-cap companies immune from shareholder proposals?
- Are the best-run companies immune from shareholder proposals?
- Is there anything a company can do to make itself less a target for shareholder proposals?

Shareholder Engagement

- How is shareholder engagement useful for companies to avoid and respond to the receipt of a shareholder proposal?
- Which proposals were most likely to be avoided or withdrawn in 2013 due to shareholder engagement?
- Are there proposals where shareholder engagement is not likely to be successful?
- What types of proponents are more receptive to engagement?
- How soon after a proposal is received should the shareholder engagement process be started?
- Who should oversee the shareholder engagement process?
- Should shareholder engagement be overseen by the executive suite, legal, investor relations or other?
- How can the appointment of a “lead shareholder” reduce the number of proposals that a company receives?

Effect of Revised ISS Policy on Board Responsiveness

- ISS will now recommend a WITHHOLD or AGAINST vote for directors where
 - in 2013, the board fails to act on a shareholder proposal that received the support of either a majority of the shares outstanding the previous year;
 - in 2013, the board fails to act on a shareholder proposal that received a majority of shares cast in the last year and one of the two previous years; or
 - in 2014, the board failed to act on a shareholder proposal that received the support of a majority of the shares cast in 2013.
- According to ISS, responding to the shareholder proposal will generally mean either full implementation of the proposal or, if the matter requires a vote by shareholders, a management proposal on the next annual ballot to implement the proposal.

Rule 14a-8 Procedural Issues

- Who is the record holder?
 - Staff Legal Bulletin No. 14F
 - Only DTC participants can be viewed as "record holders" of securities that are deposited at DTC
- Proxy proposal by proxy
 - In December 2012, the SEC denied no-action relief to Ameriprise Financial which was seeking to exclude a "proxy proposal by proxy"

Trends in 2013 SEC No-action Letters

- How has the tendency of companies in 2013 to seek exclusion no-action letters compared with previous years?
- Effect of shareholder engagement / negotiations on the need to seek no-actions request letter relief
- SEC's approach to requests to exclude a shareholder proposal on procedural grounds (e.g., record ownership, proposal by proxy, etc.)
- Timing of SEC staff responses
- Trends in SEC responses to requests for no-action letter relief
- Excluding independent chair proposals as “vague and indefinite” under Rule 14a-8(i)(3)

Litigation Related to Rule 14a-8

▪ Apache Corporation v. Chevedden

- Apache sued Chevedden in the U.S. District Court for the Southern District of Texas for not proving proof that he met SEC Rule 14a-8's share ownership requirements in connection with submitting a shareholder proposal
- U.S. District Court upheld Apache's exclusion of Chevedden's proposal, agreeing that he failed to comply with the proxy rules
- Decision was first federal judicial decision addressing the requisite proof of share ownership for submission of proposals under Rule 14a-8

Litigation Related to Rule 14a-8

▪ KBR v. Chevedden

- In November 2010, Chevedden submitted a shareholder proposal for inclusion in KBR's proxy statement for its May 2011 shareholders' meeting
- KBR contended that Chevedden's proposal was deficient because Chevedden had failed to prove that he was one of the company's shareholders
- KBR sued Chevedden in the United States District Court for the Southern District of Texas seeking a declaratory judgment that it could properly exclude the proposal
- District Court granted KBR's motion for summary judgment, ruling that KBR could properly exclude Chevedden's proposal from its proxy statement
- Chevedden appealed decision to Fifth Circuit arguing that Section 14(a) does not create a private cause of action and that his conflict with KBR lacks the immediacy and reality to give KBR standing to bring a declaratory judgment action
- Fifth Circuit affirmed the decision of the United States District Court for the Southern District of Texas that KBR may exclude Chevedden's proposal from its proxy statement" and entered judgment against Chevedden

Litigation Related to Rule 14a-8

- **National Fuel Gas v. Massachusetts Pension Reserves Investment Management Board (PRIM)**

- PRIM had submitted a board declassification proposal as a participant in the Harvard Shareholder Rights Project
- In its suit, National Fuel argued that PRIM “could not truthfully state” that at the time of the annual meeting it would hold the number of shares required to be entitled to a vote since it outsourced its voting and investment decisions to an external manager
- PRIM ultimately withdrew the proposal before it answered the complaint
- First time that a company has accused a proponent of being unable to prove that it will own and be able to vote its shares at the meeting

Litigation Related to Rule 14a-8

- Do we expect litigation to become a more frequently used tool for companies seeking to fend off a shareholder proposal?
- When should a company use litigation to exclude a shareholder proposal?
- Should a company pursuing litigation to exclude a shareholder proposal also seek a no-action letter from the SEC?
- What are the risks of pursuing litigation as opposed to an SEC no-action letter?
- Can litigation against a proponent have the effect of straining the company's relations with its other shareholders?
- Do we expect litigation to ever supplant the SEC's no-action process?
- Isn't the litigation option much more expensive and unpredictable than the SEC's no-action letter process?

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Parties that can provide proof of ownership under Rule 14a-8(b)(2)(i) for purposes of verifying whether a beneficial owner is eligible to submit a proposal under Rule 14a-8
 - For purposes of Rule 14a-8(b)(2)(i), a proof of ownership letter from an affiliate of a DTC participant satisfies the requirement to provide a proof of ownership letter from a DTC participant.
 - A shareholder who holds securities through a securities intermediary that is not a broker or bank can satisfy Rule 14a-8's documentation requirement by submitting a proof of ownership letter from that securities intermediary.
 - If the securities intermediary is not a DTC participant or an affiliate of a DTC participant, then the shareholder will also need to obtain a proof of ownership letter from the DTC participant or an affiliate of a DTC participant that can verify the holdings of the securities intermediary.

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Manner in which companies should notify proponents of a failure to provide proof of ownership for the one-year period required under Rule 14a-8(b)(1)
 - SEC will no longer concur in the exclusion of a proposal under Rules 14a-8(b) and 14a-8(f) on the basis that a proponent's proof of ownership does not cover the one-year period preceding and including the date the proposal is submitted unless the company explains what a proponent must do to remedy defects in proof of ownership letters.
 - Notice of defect must (i) identify the specific date on which the proposal was submitted and (ii) explain that the proponent must obtain a new proof of ownership letter verifying continuous ownership of the requisite amount of securities for the one-year period preceding and including such date to cure the defect.
 - SEC views the proposal's date of submission as the date the proposal is postmarked or transmitted electronically.
 - Companies should include copies of the postmark or evidence of electronic transmission with their no-action requests.

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Effect of use of website references in proposals and supporting statements on 500-word limitation in Rule 14a-8(d)
 - SEC reiterated its guidance from SLB No. 14 that a reference to a website address in a proposal does not raise the concerns addressed by the 500-word limitation in Rule 14a-8(d) and therefore will continue to count a website address as one word for purposes of Rule 14a-8(d).
 - To the extent that the company seeks the exclusion of a website reference in a proposal, but not the proposal itself, SEC will continue to follow the guidance stated in SLB No. 14, which provides that references to website addresses in proposals or supporting statements could be subject to exclusion under Rule 14a-8(i)(3) if the information contained on the website is materially false or misleading, irrelevant to the subject matter of the proposal or otherwise in contravention of the proxy rules, including Rule 14a-9.

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Rule 14a-8(i)(3) issues raised by references to website addresses in a proposal or supporting statement
 - SEC indicated that references to websites in a proposal or supporting statement may raise concerns under Rule 14a-8(i)(3) and exclusion of a proposal thereunder as vague and indefinite may be appropriate.
 - In evaluating whether a proposal may be excluded on this basis, SEC will consider only the information contained in the proposal and supporting statement and determine whether, based on that information, shareholders and the company can determine what actions the proposal seeks.
 - If a proposal or supporting statement refers to a website that provides information necessary for shareholders and the company to understand with reasonable certainty exactly what actions or measures the proposal requires, and such information is not also contained in the proposal or in the supporting statement, proposal would raise concerns under Rule 14a-9 and would be subject to exclusion under Rule 14a-8(i)(3) as vague and indefinite.

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Providing the company with the materials that will be published on the referenced website
 - SEC indicates that a reference to a non-operational website in a proposal or supporting statement could be excluded under Rule 14a-8(i)(3) as irrelevant to the subject matter of a proposal.
 - However, SEC will not concur that a reference to a website may be excluded as irrelevant under Rule 14a-8(i)(3) on the basis that it is not yet operational if the proponent, at the time the proposal is submitted, provides the company with the materials that are intended for publication on the website and a representation that the website will become operational at, or prior to, the time the company files its definitive proxy materials.

Additional SEC Guidance Over the Past Year

Staff Legal Bulletin No. 14G (CF) (October 16, 2012)

- Potential issues that may arise if the content of a referenced website changes after the proposal is submitted
 - To the extent the information on a website changes after submission of a proposal and the company believes the revised information renders the website reference excludable under Rule 14a-8, a company seeking SEC's concurrence that the website reference may be excluded must submit a letter presenting its reasons for doing so.
 - While Rule 14a-8(j) requires a company to submit its reasons for exclusion with the Commission no later than 80 calendar days before it files its definitive proxy materials, SEC may concur that the changes to the referenced website constitute "good cause" for the company to file its reasons for excluding the website reference after the 80-day deadline and grant the company's request that the 80-day requirement be waived.

Does Rule 14a-8 Need to be modernized?

- Costs of dealing with shareholder proposal matters that are not material and get little support from shareholders
 - Burden on small and mid-cap companies
- Resubmission thresholds
 - Is the 3% threshold (if proposed once within the preceding five years) resubmission threshold) too low?
 - Is the 6%(if proposed twice within the preceding 5 years) resubmission threshold too low?
 - Is the 10%(if proposed three times within the preceding 5 years) resubmission threshold too low?
 - If the proposal clears the 10% threshold, it can be resubmitted every year going forward
- Stock ownership requirements
 - Is the \$2,000 ownership requirement too low?

What to Expect in 2014

- Will support levels continue to erode as fewer large cap companies to target for majority voting and board declassification?
- More small cap and mid-cap companies to be targeted
- Proxy access? Have the activists just been fine-tuning their approach?
- Effect of recent Delaware Chancery Court decision upholding exclusive forum bylaws
 - There was a significant decrease in the number of exclusive forum bylaw provisions adopted since the commencement of the Chevron & FedEx litigation.
 - Now that exclusive forum bylaws have been upheld by the Delaware Chancery Court, expect more companies to adopt such provisions.
 - Possibility of shareholder proposals to repeal the exclusive forum bylaw at companies where it is adopted.