

Advisory

SECURITIES & CAPITAL MARKETS PRACTICE GROUP | JUNE 2012

WIGGIN AND DANA

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Proxy Access Makes a Comeback

After the SEC's attempt to broaden shareholder access to company proxy statements was unceremoniously ended last July by a federal appellate court ruling, investors have taken the initiative to address shareholder rights on a company-by-company basis. On June 5, 2012, Nabors Industries Ltd., an oil and gas drilling company, became the first U.S. public company to see its shareholders approve a non-binding proposal asking its board to adopt, and present to the shareholders for approval, a by-law amendment that would permit certain large, long-term shareholders to include their own director nominees in the company's proxy materials. This vote was a victory for activist investors seeking greater influence over corporate governance.

BACKGROUND: SEC EFFORT TO ESTABLISH MARKET-WIDE MANDATORY PROXY ACCESS RULE

In 2010, the SEC adopted a new Rule 14a-11, commonly referred to as the proxy access rule, under the Securities Exchange Act of 1934. The Dodd-Frank Act authorized the SEC to implement rules that would make companies more accountable to their shareholders, including the proxy access rule. The proxy access rule made it easier for certain shareholders to nominate and elect directors by requiring companies to include shareholder nominees in the company's proxy materials. Individual investors or investor groups would become eligible to nominate directors if they held at least a three percent stake in the company for at least three years. Pension funds and activist investors championed the rule as a way to make corporate boards more responsive to shareholders by reducing the expense of proxy fights. The rule was severely criticized by business groups that saw it as distracting to management and bowing to special interest investors.

The proxy access rule was immediately challenged in court by the U.S. Chamber of Commerce and the Business Roundtable. The challengers argued the rule was arbitrary and capricious because it violated administrative rule-making procedures by not adequately taking into account the rule's effect on efficiency, competition and capital formation. The SEC stayed the enforcement of the disputed rule, along with any action involving the amendments to Rule 14a-8 proposed at the same time, until after the conclusion of the litigation.

FEDERAL COURT OF APPEALS INVALIDATES SEC RULE

A three judge panel of the federal D.C. Circuit Court vacated Rule 14a-11 in 2011, and sharply chastised the Commission for failing to appropriately assess the rule's effect on the economy. Among the litany of failures cited in the opinion, the court found the "Commission inconsistently and opportunistically framed the costs and benefits of the rule; ... neglected to support its predictive judgments; ... and failed to respond to substantial problems raised by commentators."

In September 2011, the SEC released a statement saying it would not appeal the circuit court's decision and had no immediate plans to correct the deficiencies in the original rule-making process. However, the SEC also reiterated that revised Rule 14a-8, a shareholder proposal rule that was not subject to the court challenge, would continue into effect.

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PRIVATE ORDERING UNDER STATE CORPORATION LAWS

More than twenty U.S. companies received proxy access proposals during the 2012 proxy season. These company-by-company shareholder proposals, allowed under state corporation laws and regulated by Rule 14a-8, have come to be known as private ordering. Most companies have sought to exclude shareholder proposals by relying on SEC no-action letters. The SEC responded positively to many of the letters but did not grant relief in some.^[1] The accepted grounds for exclusion were based principally on the proposals being in excess of the allowed amount of only one proposal per shareholder under Rule 14a-8(c) or being deemed to be "vague or indefinite" under Rule 14a-8(i)(3). Aside from Nabors Industries, no other proxy access proposal received majority support.^[2] More typically, threats of shareholder proposals have been used as a cudgel to force concessions sought by investors, such as limits on executive compensation or changes in board composition and classification.

In the case of Nabors Industries, a coalition of public employee pension funds, owning 1.4% of the company's shares, spearheaded by the New York City Pension Funds, successfully petitioned and received a majority vote on a non-binding shareholder proposal regarding a by-law amendment to allow the inclusion of investor nominees in the company's proxy materials.^[3] Spurred by perceived mismanagement and long-term share price stagnation, this investor group sought to have a greater say in the company's operations. While all other proxy access shareholder proposals this proxy season have failed, the success of the Nabors Industries shareholders' proposal illustrates a path for shareholders to gain access to a company's proxy materials.

PREPARING FOR THE 2013 PROXY SEASON

As the 2012 proxy season comes to a close, it is clear that the proxy access rule is making a comeback in the form of private ordering. Companies that have experienced recent bouts of shareholder discontent should take steps to prepare themselves for the 2013 proxy season in order to avoid being broadsided by a potential wave of shareholder proxy access proposals next year.

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