CLEARY GOTTLIEB

Alert Memo

SEPTEMBER 26, 2011

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PREPARING FOR "PROXY ACCESS" SHAREHOLDER PROPOSALS

Following the SEC's decision not to seek a rehearing of the decision by the U.S. Court of Appeals for the District of Columbia Circuit vacating its "proxy access" rule (Rule 14a-11 under the Securities Exchange Act of 1934), the stay on the companion "private ordering" amendments to Rule 14a-8 was lifted and those amendments are now in effect. Companies can no longer exclude otherwise-qualifying shareholder proposals seeking to establish a procedure in a company's governing documents to permit shareholder nominees to be included in the company's future proxy statements. As with other shareholder proposals, in order to make an access proposal a shareholder need only own $2,000 of company stock and have held it continuously for one year.

While some companies may receive proxy access proposals because of their size or notoriety, or seemingly at random, others will receive them because of shareholder dissatisfaction with the company's performance, strategic direction, compensation policies or general governance profile. We expect that larger institutional investors will focus their attention on a very small number of issuers where a relatively high level of dissatisfaction exists. Of course, the most important steps a company can take to reduce the risk of receiving a proxy access proposal (or, if one is received, it obtaining substantial support or even being approved) are the same ones that apply to other potential activism: knowing who the company's major shareholders are and staying in touch with them, understanding their views and concerns, and considering what steps can be taken to address those concerns well before any proposal is received. Even if a company does not expect to be a target of a proposal in the near future, understanding the views of key shareholders on this important subject should be part of the agenda for any meetings it is planning with shareholders in anticipation of the 2012 proxy season.

Several factors are relevant in deciding how to respond to a proxy access proposal, including:

- Who made the proposal and why, and what is the proponent's background and credibility to other investors and to proxy advisory firms? Engaging with the proponent to understand the reasons for the proposal may suggest other ways to address the proponent's concerns and lead to the withdrawal of its proposal.

- Is the proposal precatory or does it seek the approval of a binding by-law

amendment?

- What are the specifics of the proposal, particularly as to the percentage ownership (and definition of beneficial ownership) and holding period requirements? The specifics (including how they compare with the 3%, three-year requirements of invalidated Rule 14a-11) may affect the reactions of other shareholders and proxy advisory firms and thus the likelihood that the proposal would be approved.

- What is the company's shareholder makeup?

- How do major shareholders view the company's performance, strategy, compensation policies and governance?

ISS and Glass Lewis have both stated that they will make their recommendations on a case-by-case basis. ISS has stated that it will take into account the proposed ownership threshold and "the proponent's rationale…in terms of board and director conduct."

Discussed briefly below are steps companies should consider taking in response to a proxy access proposal and, indeed, may wish to consider now as part of their preparation for the 2012 proxy season.

1. Consider Whether to Submit a No-Action Request to Exclude the Proposal

As with any shareholder proposal, a company should consider whether there are grounds to seek an SEC staff no-action letter permitting exclusion of the proposal.[1] Among the possible bases for exclusion are a lack of timeliness of the proposal; the failure of the proponent to adequately establish continuous ownership of $2,000 of shares for one year; that the proposal would, if adopted, violate state law; or that the proposal or the supporting statement is materially false or misleading (including by being so vague that it is misleading).[2]

[1] The company can also decide to exclude a proposal without obtaining (or even seeking) no-action relief, and either bring a declaratory judgment action against the proponent or prepare to defend an action brought by the proponent. This approach to exclusion could be predicated on the belief that a basis for exclusion exists under Rule 14a-8 or that the amendments to Rule 14a-8 were not validly adopted by the SEC. Conversely, even if the company seeks and obtains no-action relief permitting exclusion of a proposal, the proponent shareholder can appeal to the courts.

[2] The proposal also cannot seek to (i) disqualify a nominee standing for election, (ii) remove a director from office before his or her term expired, (iii) question the competence, business judgment, or character of one or more nominees or directors, (iv) include a specific individual in the company's proxy material for election to the board of directors or (v) affect the outcome of the election of directors at the same annual meeting.

2. Consider Whether to Include the Proposal and the Board's Recommendation

If the Board of Directors believes the proposal is in the best interests of the company, it can either support the proposal or submit it as its own. If the Board is generally supportive of the concept of proxy access but disagrees with some of the specifics of the particular shareholder proposal, it can seek to negotiate revisions with the proponent or, as discussed below, submit its own proposal to shareholders. Although we believe most Boards will want to take a clear position on a proxy access proposal, there may be circumstances where a neutral position would be a viable option.

If the Board believes the proposal is inadvisable, the company should include in its proxy statement a well-reasoned and clear explanation of the reasons for its recommendation and should consider other steps to communicate its position and rationale. These could include meetings with shareholders and proxy advisory firms, the use of additional soliciting materials and vigorous solicitation by the company and its proxy soliciting firm.

3. Consider Whether to Propose or Adopt an Alternative Proxy Access By-Law

A company may instead wish to propose its own proxy access provision. This approach permits shareholders to vote on what the Board believes to be a carefully drafted provision that makes sense for the company in light of its particular governance framework and shareholder profile. This approach also permits the company to seek exclusion of the shareholder proposal on the grounds that it would conflict with the company's own proposal. Based on recent no-action precedents regarding other types of governance proposals, there appears to be a good chance that the SEC staff would permit exclusion of a shareholder proposal in such circumstances. However, the staff attitude towards conflicting management proposals could evolve, either generally or in this new context, and the conclusion in a particular situation may depend on whether the staff views the specifics of the two proposals as creating a "direct conflict."

Submission of the company's own proposal may be particularly worthy of consideration if the shareholder has proposed a binding by-law amendment containing provisions that the Board believes are inappropriate (*e.g.*, an unreasonably low ownership threshold or holding period, or a definition of "beneficial ownership" that fails to take into account economic short-positions), but that might be approved in the absence of an alternative. In view of the limited time a company may have to respond if it receives a proxy access proposal, it may want to prepare a potential access by-law amendment in advance that could be fine-tuned and considered by the Board quickly.

A company could go one step further and adopt an amendment to its by-laws providing for proxy access. This approach potentially could forestall a shareholder proposal or provide a basis for excluding a shareholder proposal on the grounds that it has been "substantially implemented." Experience in other governance contexts, however, has shown that shareholders will not be deterred by a company's proactive changes if they disagree with the

approach taken, and recent no-action correspondence suggests that the SEC has narrowed its view of what constitutes "substantial implementation." Given the highly charged context in which the Rule 14a-8 amendments have become effective, as well as the SEC staff's support of proxy access generally, it would not be surprising if the staff refused to grant no-action relief where there was a meaningful divergence between key elements of the company's by-law amendment and the shareholder proposal, notably the ownership threshold and holding period. The Board's adoption of an access by-law could nevertheless provide it with greater flexibility, both from an investor relations perspective and conceivably under corporate law in some states, to amend, or even repeal, the access by-law if later warranted by the company's circumstances or by the experience of other companies generally with shareholder access.

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Please feel free to call any of your regular contacts at the firm or any of the partners and counsel under Corporate Governance in the Practices section of our website (www.cgsh.com) if you have any questions.

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