SIDLEY AUSTIN LLP
SIDLEY

November 4, 2015

SIDLEY UPDATE

Is Proxy Access Inevitable?

Review of 2015 Proxy Access Results and Provisions – Related Considerations for Boards and Counsel

This article revises our Sidley Updates issued July 24, 2015 and September 29, 2015 to reflect the most recent developments relating to proxy access, including new SEC guidance and draft proxy voting policy updates issued by Institutional Shareholder Services (ISS). Among other things, we have updated the chart of proxy access provisions in Appendix A (which are presented on a company-by-company basis as of November 3, 2015) to add the terms adopted by 25 companies since our last update.

Efforts by shareholders to directly influence corporate decision-making are intensifying, as demonstrated by the significant increase over the past three years in financially focused shareholder activism and the more recent efforts by large institutional investors to encourage directors to "engage" with shareholders more directly.

Through the collective efforts of large institutional investors, including public and private pension funds, shareholders at a significant number of companies are likely, within the next several years, to gain the power to nominate a portion of the board without undertaking the expense of a proxy solicitation. By obtaining proxy access (the ability to include shareholder nominees in the company's own proxy materials), shareholders will have an additional lever to pull to influence board decisions.

Snapshot of Proxy Access Provisions Adopted in 2015 (as of November 3, 2015)

Provision	Prevalence of Selected Alternatives	Shareholder Viewpoints*	Proxy Advisory Firm Policies and CII Position
Ownership threshold and duration	• 3% / 3 years – 55/62 (89%); included in SEC vacated rule • 5% / 3 years – 7/62 (11%)	• Most favor 3% • Vanguard favors 5% • Shareholder proposals more likely if adopt 5%	• ISS and GL support 3% • CII supports 3% and views 5% as "troublesome"
Nominee limit (Max. % of board)	• 20% cap – 32/62 (52%) • Greater of 2 or 20% – 20/62 (32%) • 25% cap – 10/62 (16%); included in SEC vacated rule	• Most favor 20-25%	• ISS and GL support 25% • Less than 20% identified as "problematic" in ISS policy survey • CII favors ability to nominate at least two candidates
Nominating group size limit	• 20 – 51/62 (82%) • 15 – 3/62 (5%) • 10 – 4/62 (6%) • 5 – 1/62 (2%) • 1 – 1/62 (2%) • No limit – 2/62 (3%); included in SEC vacated rule	• General consensus that limit of 20 is reasonable • Possibility of shareholder proposals seeking removal of limits	• ISS favors minimal or no limits; less than 20 identified as "problematic" in ISS policy survey • CII views *any* limit as "troublesome"

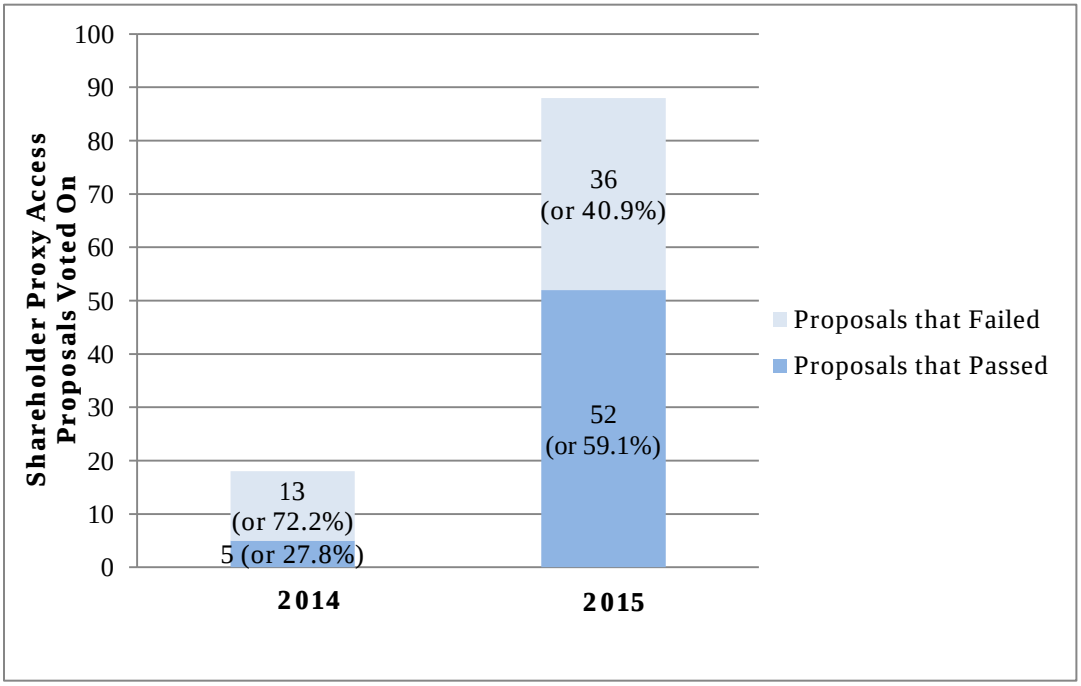
* Derived from publicly available voting policies as well as preferences expressed through engagement and voting results.

While proxy access has been the subject of shareholder proposals for several years, 2015 is a tipping point. This year's proxy season saw a significant increase in the number of shareholder proxy access proposals and shareholder support for such proposals (see highlights box below), as well as an increased frequency of negotiation and adoption of proxy access via board action – including an accelerating trend towards board adoption without having received a shareholder proposal – or, to a lesser extent so far, submission of a management proposal to a shareholder vote.

Key Highlights of Shareholder Proxy Access Proposals Voted on in 2015*

- 88 proposals were voted on, up from 18 in 2014
- 52 passed (59.1% of the total), up from 5 (27.8%) in 2014
- 36 did not pass (40.9% of the total), compared to 13 (72.2%) in 2014
- Average percentage of votes cast in favor was 54.3%, up from 34.0% in 2014

* Data points in this update are derived from SharkRepellent.net, last accessed on November 3, 2015. All voting results in this update are calculated on the basis of votes cast "for" the proposal divided by the sum of votes cast "for" and "against" that proposal (not taking into account abstentions).



Proxy access initiatives had limited levels of success in years prior to 2015. However, shareholder support started to increase in 2014 as proponents began to focus on the 3% for three years ownership requirement adopted by the Securities and Exchange Commission (SEC) in its 2010 rulemaking efforts (as described below).

This year, with a major initiative from public pension funds led by New York City Comptroller Scott M. Stringer and with encouragement from major investors, such as TIAA-CREF, and the large institutional investor industry group, the Council of Institutional Investors (CII), proxy access is taking hold. Adding to the momentum is the SEC's removal for the 2015 proxy season of a key defense in the form of no-action relief in situations in which a company intends to put forward its own competing proposal. Proxy advisory firm policies that support proxy access and discourage efforts to defend against proxy access proposals add to the momentum. Moreover, in

August 2014, the CFA Institute published a report discussing the potential economic benefits of proxy access; this report has been cited by Comptroller Stringer and several other proponents in their proposals.[1]

The broad-based shareholder campaign for proxy access on a company-by-company basis, and the apparent momentum developing among targeted companies and other leading companies to respond by taking action to adopt proxy access (with or without a shareholder proposal), is reminiscent of the campaign several years ago for companies to replace plurality voting with majority voting in the uncontested election of directors. Both issues relate to the ability of shareholders to influence the composition of the board, and both campaigns show the power of concerted efforts at private ordering.

Overview

The SEC's 2010 Proxy Access Rule

The SEC has unsuccessfully sought to adopt a market-wide proxy access rule for decades. Most recently, in 2010, the SEC adopted a proxy access rule (Exchange Act Rule 14a-11) that would have given shareholders the ability to nominate candidates through the company's proxy materials if a shareholder (or a group of shareholders without any limit on the size of the nominating group) held 3% of the company's shares for at least three years. Under the rule, a nominating shareholder (or group of shareholders, with no limit on the size of the group) could nominate one proxy access director, or 25% of the board, whichever is greater. Rule 14a-11 was adopted shortly after Section 971 of the Dodd-Frank Act confirmed the SEC's authority to promulgate a proxy access rule. The SEC issued final rules mandating proxy access in August 2010, which were scheduled to become effective in November 2010. In addition, the SEC also amended Exchange Act Rule 14a-8(i)(8) to allow shareholder proposals relating to proxy access and certain other director election mechanisms.[2]

In September 2010, Business Roundtable and the U.S. Chamber of Commerce challenged Rule 14a-11. In 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated Rule 14a-11 on the grounds that the SEC had acted "arbitrarily and capriciously" in promulgating the rule and failing to adequately assess its economic impact.[3] The SEC did not appeal the court's decision and has not re-proposed any proxy access rule since that

decision; however, the amendment to Rule 14a-8 described above became effective in September 2011, thereby opening the door to shareholder proposals seeking proxy access.[4]

Uptick in Shareholder Proxy Access Proposals in 2015

In public comments on the SEC's proposed Rule 14a-11, several commenters expressed the view that the matter should be left to shareholders and companies to decide on a company-by-company basis through private ordering.[5] Private ordering may take place, for example, pursuant to Section 112 of the Delaware General Corporation Law.[6]

Approximately 15 companies adopted proxy access prior to 2015, including a few large companies, such as Hewlett-Packard Company (now known as HP Inc.), The Western Union Company and Verizon Communications Inc., which each adopted proxy access after receiving a shareholder proposal on the topic, as well as some companies that have since gone private. In addition, proxy access with a 5% for two years ownership threshold has been mandatory for companies incorporated in North Dakota since 2008; and we are aware of one public company that reincorporated to North Dakota with the stated purpose of taking advantage of this and other "shareholder-friendly" provisions.[7] To date, no shareholder has included a director nominee in the proxy materials of a United States company pursuant to a proxy access right.[8]

The private ordering effort is now in full swing. Shareholder proposals seeking proxy access were the defining feature of the 2015 proxy season, with more than 115 companies receiving proposals requesting that the board amend the bylaws to allow large, long-standing shareholders (or groups of shareholders) to nominate directors and include those nominees in the company's own proxy statement and related materials. The number of shareholder proxy access proposals submitted for the 2015 proxy season is more than four times the number submitted for the 2014 proxy season.

The New York City Pension Funds, with approximately $160 billion under management, accounted for the majority of the proxy access proposals submitted for the 2015 proxy season. In November 2014, Comptroller Stringer announced the "Boardroom Accountability Project," targeting 75 companies with non-binding shareholder proxy access proposals.[9] The proposals request that the board adopt a bylaw to give shareholders who meet a threshold of owning 3% of the company's stock for three or more years the right to include their director candidates, representing up to 25% of the board, in the company's proxy materials, with no limit on the number of shareholders that could comprise a nominating group. According to Comptroller Stringer, the targeted companies were selected due to concerns about the following three priority issues:

- Climate change (i.e., carbon-intensive coal, oil and gas and utility companies).
- Board diversity (i.e., companies with little or no gender, racial or ethnic diversity on the board).
- Excessive executive compensation (i.e., companies that received significant opposition to their 2014 say-on-pay votes).

Although members of Comptroller Stringer's office have publicly stated that they intend to continue their efforts in this area, they have not yet disclosed the priority issues they intend to target in 2016.

Institutional Investor Support for Proxy Access

Proxy access is supported by many institutional investors, including the following:

- *BlackRock* – will review proxy access proposals on a case-by-case basis and generally support them provided that their parameters are not "overly restrictive or onerous" and "provide assurances that the mechanism will not be subject to abuse by short-term investors, investors without a substantial investment in the company, or investors seeking to take control of the board."[10] In early October 2015, BlackRock announced that it will put a management proxy access proposal on the ballot for its annual meeting in May 2016 with the following terms: 3% for three years for up to 25% of the board with a group size limit of 20.
- *California Public Employees' Retirement System (CalPERS)* – has indicated that proxy access is one of its strategic priorities for the 2015 proxy season and its support of proxy access proposals at 100 companies this year.[11]
- *California State Teachers' Retirement System (CalSTRS)* – supports proxy access at the 3% for three years threshold, capped at a minority of board seats.[12]
- *TIAA-CREF* – wrote to the 100 largest companies in which it invests in February 2015, encouraging them to adopt proxy access at the 3% for three years threshold.[13]
- *T. Rowe Price* – supports proxy access for owners of 3% or more of the company's outstanding shares, with a holding period requirement of no less than two years and no more than three years.[14]
- *Vanguard* – generally supports proxy access at the 5% for three years threshold, capped at 20% of board seats.[15]

Fidelity generally votes against management and shareholder proposals to adopt proxy access.[16]

CII has long supported proxy access, favoring a broad-based SEC rule imposing proxy access. Absent such a rule, Section 3.2 of CII's *Corporate Governance Policies* states that a company should provide access to management proxy materials for an investor or a group of investors that have held in the aggregate at least 3% of the company's voting stock for at least two years, to nominate less than a majority of the directors.[17]

On August 5, 2015, CII issued guidelines setting forth what it considers best practices for companies adopting proxy access provisions. The guidelines highlight seven provisions that CII finds "troublesome" in that they could "significantly impair shareowners' ability to use proxy access, or even render access unworkable."[18] The provisions that are of most concern to CII are:

- An ownership threshold of 5%.
- The percent or number of board members that may be elected could result in fewer than two proxy access nominees.
- Aggregation of shareholders to form a nominating group is limited to a specified number.
- Not counting loaned shares (that meet certain conditions with respect to recall and voting) toward the ownership threshold during the holding period.
- A requirement for a nominating shareholder to continue to hold the requisite percentage of shares after the annual meeting.

- Re-nomination restrictions in the event a proxy access nominee fails to receive a specified minimum percentage of votes.
- Prohibitions on third-party compensation arrangements with proxy access nominees (although CII supports disclosure of such arrangements).

When the guidelines were issued, the interim executive director of CII stated that every proxy access provision in effect at the time included at least one of these "troublesome" provisions.[19]

In mid-October 2015, CII reported that the United Brotherhood of Carpenters recently sent letters to 50 companies seeking a proxy access right in the event that the board refuses to accept the resignation of an incumbent director who fails to receive majority support.[20] The letters were sent to companies with a majority voting standard and a director resignation policy and that had shareholder proxy access proposals on the ballots for their 2015 annual meetings, whether or not those proposals received majority support.

Some institutional investors that favor proxy access coordinated their efforts during the 2015 proxy season in an attempt to increase investor support for the proxy access proposals they sponsored. Specifically, the New York City Pension Funds, CalPERS and other large labor-affiliated pension funds each filed Form PX14A6Gs with the SEC enabling them to communicate in support of their proxy access proposals (but not collect actual proxies) without such communications being subject to the proxy solicitation rules.

According to a recent report by Broadridge and PricewaterhouseCoopers, institutional investors are four times more likely to support proxy access than are individual investors: 61% of votes cast by institutional investors were in favor of proxy access in 2015, compared with only 15% of those cast by individual retail investors.[21] The report also indicated that retail investors voted only 28% of the shares they own. These findings suggest that companies facing a proxy access vote should consider ways of engaging with retail investors and encouraging them to vote.

Proxy Advisory Firm Policies on Proxy Access

Both Institutional Shareholder Services (ISS) and Glass, Lewis & Co. generally favor proxy access for significant, long-term shareholders.

ISS

In prior years, ISS analyzed proxy access proposals on a case-by-case basis. Beginning with the 2015 proxy season, ISS will generally recommend in favor of shareholder and management proxy access proposals with all of the following features:

- An ownership threshold of not more than 3% of the voting power.
- A holding period of no longer than three years of continuous ownership for each member of the nominating group.
- Minimal or no limits on the number of shareholders that may form a nominating group.
- A cap on the number of available proxy access seats of generally 25% of the board.

ISS will review any additional restrictions for reasonableness. Where a company includes both a management proposal along with a shareholder proposal, ISS will compare them in relation to the guidance above. ISS will generally recommend a vote against proposals that are more restrictive than the ISS guidelines.

ISS will also generally recommend a vote against one or more directors if a company omits from its ballot a properly submitted shareholder proxy access proposal, if the company has not obtained any of the following:

- The proponent's voluntary withdrawal of the proposal.
- A grant of SEC no-action relief.
- A U.S. district court ruling that exclusion is appropriate.[22]

On November 2, 2015, ISS announced that, beginning on November 23, 2015, its QuickScore governance ratings product will track, on a "zero-weight" basis, whether a company has adopted proxy access. In particular, ISS will track the minimum ownership threshold and holding period, the maximum number of shareholders that can comprise a nominating group and the maximum percentage or number of board seats open to proxy access nominees.[23]

Glass Lewis

Glass Lewis' proxy voting policies for 2015 provide that it will review on a case-by-case basis shareholder proxy access proposals and the company's response, including whether the company offers its own proposal in place of, or in addition to, the shareholder proposal. Glass Lewis will consider:

- Company size.
- Board independence and diversity of skills, experience, background and tenure.
- The shareholder proponent and the rationale for the proposal.
- The percentage of ownership requested and the holding period requirement; although note that Glass Lewis policy does not specify a preferred percentage.
- The shareholder base in both percentage of ownership and type of shareholder (such as a hedge fund, activist investor, mutual fund or pension fund).
- Board and management responsiveness to shareholders, as evidenced by progressive shareholder rights policies (such as majority voting or board declassification) and reaction to shareholder proposals.
- Company performance and steps taken to improve poor performance (such as appointing new executives or directors or engaging in a spin-off).
- Existence of anti-takeover protections or other entrenchment devices.
- Opportunities for shareholder action (such as the ability to act by written consent or the right to call a special meeting).[24]

Glass Lewis does not solicit feedback on its policy updates, which are typically released in November.

ISS Proxy Access Responsiveness Policy

ISS launched its annual policy survey[25] in August 2015, thereby signaling that ISS may refine its position on proxy access.[26] Specifically, the survey asks: if a board adopts proxy access with material restrictions not contained in a majority-supported shareholder proposal, which types of restrictions should be viewed as problematic enough to call into question the board's responsiveness and potentially warrant "withhold" or "against" votes against directors? ISS provided the following examples of potentially problematic restrictions:

- Ownership thresholds in excess of 3% or 5%.
- Ownership duration greater than three years.
- Aggregation limit of less than 20 shareholders.
- Cap on proxy access nominees set at less than 20% of the existing board (rounded down).
- More restrictive advance notice requirements.
- Information disclosures that are more extensive than those required of the company's nominees, by the company, the SEC or relevant exchanges.
- Re-nomination restrictions in the event a proxy access nominee fails to receive a stipulated level of support or withdraws his or her nomination.
- Restrictions on compensation of proxy access nominees by nominating shareholders.

The inclusion of this question in the survey suggests that ISS may issue negative vote recommendations against directors of companies that do not implement a majority-supported shareholder proxy access proposal substantially in accordance with its terms.

On September 28, 2015, ISS published the results of its annual policy survey.[27] A majority of investor respondents were of the view that ISS should issue negative vote recommendations against directors if the ownership threshold exceeds 3% (72% of investor respondents) or 5% (90%), if the holding period exceeds 3 years, if the size of the nominating group is fewer than 20 and/or if the cap on the number of proxy access nominees is less than 20% of the current board size. Company respondents generally did not agree that directors should be penalized for imposing restrictions on proxy access after shareholders had approved a shareholder proxy access proposal, although a slight majority agreed that votes against directors could be warranted if the company established an ownership threshold greater than 5%.

The policy survey did not seek feedback on ISS proxy voting policy with respect to proxy access proposals (e.g., to include consideration of the provisions listed above that are not currently addressed in the policy); however, ISS could nevertheless change its policy to incorporate such considerations or any other matter.

On October 26, 2015, ISS issued its key proposed draft policy changes applicable to the 2016 proxy season for public comment, none of which relate to proxy access. Although ISS has in the past announced policy changes that were not submitted for public review, it has indicated in preliminary discussions that it does not expect to make any major changes to its policy relating to proxy access. ISS expects to release its final policy updates applicable to the 2016 proxy season on November 18, 2015.

Grounds for Exclusion of Shareholder Proxy Access Proposals

Under the SEC's proxy rules, a company may exclude a shareholder proxy access proposal from its proxy materials if the proposal fails to meet any of the procedural and substantive requirements of Exchange Act Rule 14a-8. A company may seek no-action relief from the SEC Staff, pursuant to which the company can exclude the proposal from its proxy materials. Two substantive grounds that have been relied on by companies seeking to exclude a shareholder proxy access proposal are that the proposal directly conflicts with a management proposal (Rule 14a-8(i)(9)) or has already been substantially implemented by the company (Rule 14a-8(i)(10)). However, as discussed below, the SEC Staff recently issued guidance that will make it more difficult for a company to obtain no-action relief under Rule 14a-8(i)(9) on the grounds that a shareholder proxy access proposal directly conflicts with a management proxy access proposal.

Directly Conflicting Proposals

In early December 2014, the SEC's Division of Corporation Finance granted no-action relief to Whole Foods Market, Inc. on the basis that a 3% for three years shareholder proxy access proposal directly conflicted with a 9% for five years management proposal.[28] When Whole Foods filed its preliminary proxy statement with the SEC after this relief was granted, the ownership threshold in the management proposal was reduced from 9% to 5%.

In the wake of the no-action relief granted to Whole Foods, it was broadly expected that companies would counter shareholder proxy access proposals by putting forward management proxy access proposals with higher minimum ownership thresholds, and obtain no-action relief on the basis that the proposals were conflicting and therefore excludable. However, following the grant of no-action relief to Whole Foods, James McRitchie, the proponent of the Whole Foods proposal, appealed the grant to the full SEC and a letter-writing campaign by incensed institutional shareholders followed.

In January 2015, SEC Chair Mary Jo White reversed course. In an unusual development, Chair White directed the SEC Staff to review Rule 14a-8(i)(9) as a basis for exclusion. As discussed in a previous Sidley Update,[29] following Chair White's direction, the Division of Corporation Finance announced that it would express no view on the application of Rule 14a-8(i)(9) for the remainder of the 2015 proxy season in connection with all shareholder proposals—not just those seeking proxy access—and withdrew the no-action relief previously granted to Whole Foods.[30]

Business Roundtable and other commentators expressed concern that the SEC's approach forced companies faced with a shareholder proxy access proposal that are considering a management proposal to either include the shareholder proposal in the proxy materials, even though it will compete with the similar management proposal and possibly lead to confusion, or omit the shareholder proposal, creating a heightened risk of litigation and negative targeting by certain pension funds and proxy advisory firms. As described below, seven companies have included competing shareholder and management proxy access proposals on the ballot. We are not aware of any company omitting a shareholder proxy access proposal without first obtaining no-action relief or withdrawal. In a speech in late June 2015, SEC Chair White noted that, notwithstanding concerns that shareholders would be confused by two competing proposals, "shareholders were able to sort it all out and express their views."[31]

New SEC Guidance on Excludability of Directly Conflicting Shareholder Proposals

On October 22, 2015, the Staff of the SEC's Division of Corporation Finance issued Staff Legal Bulletin No. 14H (CF) ("SLB No. 14H")[32] which provides new guidance on the excludability of shareholder proposals that "directly conflict" with management proposals under Rule 14a-8(i)(9). As discussed in a previous Sidley Update,[33] after reviewing the history and intended purpose of Rule 14a-8(i)(9) per SEC Chair White's request, the SEC Staff announced in SLB No. 14H that it will interpret the rule more narrowly than it has in the past. Going forward, the SEC Staff will permit a company to exclude a shareholder proposal as directly conflicting with a management proposal only "if a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one proposal is tantamount to a vote against the other proposal."

A non-binding shareholder proposal seeking proxy access on terms different from management's proxy access proposal will generally not be excludable under Rule 14a-8(i)(9). Proposals seeking a similar objective (*e.g.*, proxy access) but on different terms (*i.e.*, a different means of accomplishing the same objective) would not "directly conflict," as a reasonable shareholder could logically vote in favor of both proposals. The SEC Staff provided the following example of proposals that will not be deemed to directly conflict: (i) a management proposal that seeks to allow shareholders holding at least 5% of the company's stock for at least five years to nominate up to 10% of the directors and include nominees in the company's proxy materials and (ii) a shareholder proposal that seeks to allow shareholders holding at least 3% of the company's stock for at least three years to nominate up to 20% of the directors and include nominees in the company's proxy materials.

The SEC Staff does not believe that a reasonable shareholder would logically vote for two binding shareholder and management proposals that contain two mutually exclusive mandates. In the case of such a "direct conflict," the SEC Staff could, in its no-action response, allow a shareholder proponent to revise its proposal to make it non-binding rather than binding, and therefore potentially not excludable under Rule 14a-8(i)(9).

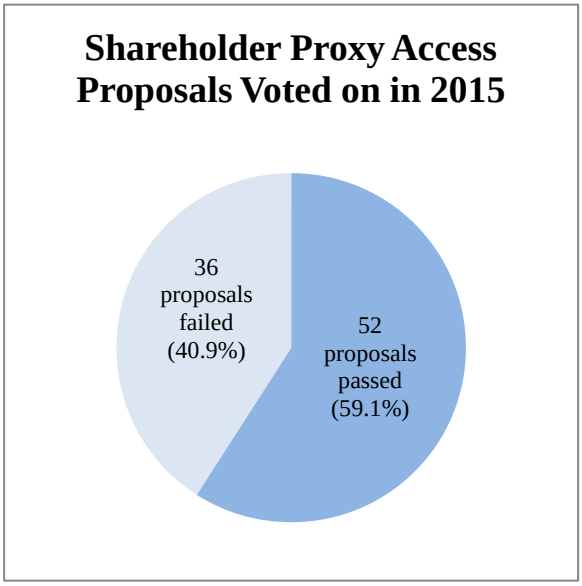
In light of the new guidance, we expect to continue to see competing proxy access proposals on ballots during the 2016 proxy season. In a situation where both the management and shareholder proposals are approved by shareholders, the board may have to consider the effects of both proposals; the SEC Staff does not consider such a decision to represent the kind of "direct conflict" the rule was designed to address. In SLB No. 14H, the SEC Staff noted that, to minimize concerns about shareholder confusion, any company that includes shareholder and management proposals on the same topic on its ballot can include proxy statement disclosure explaining the differences between the two proposals and how the company would expect to consider the voting results.

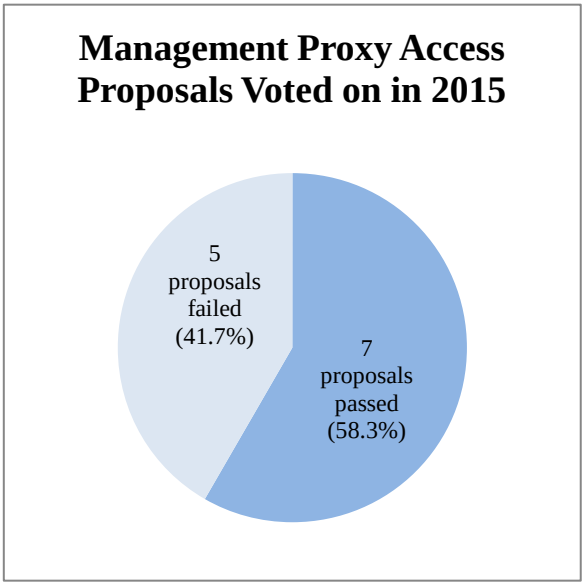
Substantially Implemented Proposals

Companies that adopt proxy access can seek to omit a shareholder proxy access proposal on the grounds that it has been "substantially implemented" by the company.

In March 2015, the SEC granted General Electric Company no-action relief allowing it to exclude a shareholder proxy access proposal on these grounds. The shareholder proposal had sought an ownership threshold of 3% for three years, for up to 20% of the board's seats but was silent on the number of shareholders that could comprise a nominating group. General Electric adopted a proposal with the same 3% for three years threshold for up to 20% of board seats, but limited to 20 the number of shareholders that could compromise a nominating group.[34]

Voting Results on Proxy Access Proposals





Proxy access proposals with a 3% for three years ownership threshold have a fair likelihood of receiving majority shareholder support.

Shareholder Proposals

Eighty-eight shareholder proxy access proposals have been voted on in 2015, averaging support of approximately 54% of votes cast; 52 proposals (59.1%) have received majority support while 36 (40.9%) did not pass. Management opposed all but three of the proposals; it supported two of the proposals and provided no recommendation with respect to one proposal. ISS supported all shareholder proposals, most of which included a 3% for three years ownership threshold (such as Comptroller Stringer's proposals).

Voting results on shareholder proxy access proposals in 2015 appear to be influenced by the following factors:

Factors Increasing Shareholder Support	Factors Decreasing Shareholder Support
• No competing management proxy access proposal on the ballot	• Competing management proxy access proposal on the ballot
• Company has not adopted proxy access prior to the meeting	• Company has adopted proxy access prior to the meeting; significantly lower support if previously adopted at 3% ownership threshold
• Less insider ownership	• Greater degree of insider ownership
• Less voting retail shareholders	• More voting retail shareholders
• Combative tone of corporate disclosure around proxy access concept	• More conciliatory/open tone of corporate disclosure around proxy access concept
• Concerns relating to corporate performance, shareholder rights and/or compensation	• Lack of concern relating to corporate performance, shareholder rights and/or compensation
• Shareholder proposal voted on later in the proxy season, as momentum towards proxy access has accelerated	• Shareholder proposal voted on earlier in the proxy season

In 2014, 18 shareholder proxy access proposals were voted on and averaged support of approximately 34% of votes cast. Five proposals passed, each of which included a 3% for three years ownership requirement. The eight proposals that deviated from that formulation received average support of only 9% of votes cast. Thirteen proposals did not pass.

Management Proposals

Twelve management proxy access proposals have been voted on in 2015, averaging support of 61.5% of votes cast; seven proposals (58.3%) passed while five (41.7%) did not pass (including one that received majority support but fell short of the company's supermajority vote requirement). ISS recommended votes in favor of five of these proposals (which followed the 3% for three years formulation) and against seven of these proposals (six of which included a 5% for three years ownership threshold; one included a 3% for three years threshold (as discussed below)).

Competing Shareholder and Management Proposals

At seven companies shareholders voted on two proxy access proposals at the 2015 annual meeting—a shareholder proposal at a 3% ownership threshold and a management proposal at a 5% ownership threshold (other than one management proposal at a 3% threshold). ISS recommended for all seven shareholder proposals. ISS recommended against all seven management proposals, including at the one company which proposed a 3% for three years threshold but imposed more restrictive terms than the shareholder proposal. Specifically, the management proposal at that company included a cap of 20% of board seats (compared with a 25% cap in the shareholder proposal) and a limit of 20 shareholders in the nominating group (compared with no limit in the shareholder proposal).

As shown in the table below, the management proposal passed at three companies, the shareholder proposal passed at three companies, neither proposal passed at one company and there were no instances where both proposals passed. As noted above, SEC Chair White recently stated that, despite the concerns of some commentators, there did not appear to be shareholder confusion with respect to competing proposals. We expect to continue to see competing proxy access proposals on ballots in the 2016 proxy season in light of the new SEC guidance on Rule 14a-8(i)(9) discussed above.

	Shareholder Proposals			Management Proposals		
Company	**Parameters**	**ISS Rec.**	**% Support***	**Parameters**	**ISS Rec.**	**% Support***
The AES Corporation	3% 3 years 25% cap No limit on size of nominating group	For All	66.4	5% • 3 years • 20% cap • monitoring peer company practices and soliciting shareholder input when fixing limit (Advisory)	Against All	36.2
Chipotle Mexican Grill, Inc.			49.9	5% • 3 years • 20% cap • limit of 20 (Binding)		34.7
Cloud Peak Energy Inc.			71.1	5% • 3 years • 10% cap • limit of 1 (Binding)		25.9
Exelon Corporation			43.6	5% • 3 years • 20% cap • limit of 20 (Advisory)		52.6
Expeditors International of Washington, Inc.			35.0	3% • 3 years • 20% cap • limit of 20 (Advisory)		70.3
SBA Communications Corporation			46.3	5% • 3 years • 20% cap • limit of 10 (Advisory)		51.7
Visteon Corporation			75.7	5% • 3 years • 20% cap • monitoring peer company practices and soliciting shareholder input when fixing limit (Advisory)		21.2
Average % Support of Votes Cast			**55.4**			**41.8**

Adoption of Proxy Access Provisions During 2015 and Typical Parameters

Sixty-two companies have adopted proxy access during 2015, and they have done so in a range of circumstances as described in the chart included in Appendix A. All companies adopted proxy access in their bylaws except for one company, which incorporated it into the certificate of incorporation. Thirteen companies adopted proxy access without having received a shareholder proxy access proposal – this trend is accelerating.

That chart included in Appendix A highlights the key parameters of the proxy access provisions adopted so far this year, including the minimum ownership threshold, the maximum percentage of board seats open to proxy access nominees and the maximum number of shareholders that can comprise a nominating group. The chart also highlights additional selected provisions relating to the treatment of loaned shares, share ownership post-annual meeting, third-party compensation arrangements, the nomination deadline and exclusion of proxy access nominees if a director nomination has been made under the company's advance notice provision.

Based on data derived from SharkRepellent.net, last accessed on November 3, 2015, more than 10% of companies in the S&P 500 have now adopted proxy access. Several additional companies have publicly committed to adopt proxy access in 2015 or 2016, including companies which made such commitments in exchange for the withdrawal of a shareholder proxy access proposal, and companies where non-binding management proxy access proposals received majority support in 2015. At three companies that adopted a proxy access bylaw prior to the 2015 annual meeting, their respective boards subsequently amended the bylaws after shareholder proxy access proposals with less restrictive terms passed at the annual meetings. Specifically, CF Industries Holdings, Inc., Marathon Oil Corporation and The Priceline Group Inc. amended their proxy access bylaws to (i) decrease the required ownership percentage from 5% to 3% and (ii) change the maximum percentage of board seats available to proxy access nominees from 20% to 25%. The amendment to The Priceline Group Inc.'s bylaw also eliminated the 20 shareholder limit on forming a group for purposes of meeting the required ownership percentage.

While market practice continues to develop, the proxy access provisions adopted by companies during 2015 include several elements that are beginning to emerge as typical, although there are some variations. In addition to the key parameters and selected provisions described in the chart included in Appendix A, proxy access provisions delineate various procedural and informational requirements, proxy access nominee eligibility conditions and circumstances in which a company will not be required to include a proxy access nominee in its proxy materials.

Typical Provisions

Nomination Deadline; Limited to Annual Meetings

Requests to include proxy access nominees in the company's proxy materials typically must be received within a window of 120 to 150 days before the anniversary of (1) the date on which the company released its proxy statement for the previous year's annual meeting (40 out of 62 companies (65%)) or (2) the previous year's annual meeting (7 out of 62 companies (11%)). Less commonly, the deadline is a window of 90 to 120 days before the anniversary of the previous year's mailing date (2 out of 62 companies (3%)) or annual meeting date (5 out of 62 companies (8%)). Seven out of 62 companies (11%) require that requests be received prior to the date that is 120 days before the date the company released its proxy statement to shareholders in connection with the previous year's annual meeting (i.e., the same as the deadline for shareholder proposals under Exchange Act Rule 14a-8, which does not incorporate a window). Proxy access provisions typically specify that

proxy access may only be used with respect to director elections at annual meetings (but not special meetings) of shareholders.

Net Long Beneficial Ownership of 3% or 5%

Three percent for three years is emerging as the most common ownership threshold (55 out of 62 companies (89%)), although some companies have adopted a 5% for three years threshold (7 out of 62 companies (11%)). As discussed above, three companies that initially adopted proxy access at a 5% ownership threshold subsequently amended their bylaws to decrease the required ownership percentage to 3%.

A nominating shareholder is typically deemed to own only those outstanding common shares of the company as to which the shareholder possesses both the full voting and investment rights pertaining to the shares, and the full economic interest in such shares. For example, shares subject to any derivative arrangement entered into by the shareholder or any of its affiliates would not qualify as eligible ownership for proxy access purposes. Loaned shares count as "owned" for purposes of meeting the ownership threshold in most of the proxy access provisions adopted to date (45 out of 62 companies (73%)), subject to certain conditions. Where loaned shares count toward ownership, most provisions require that the nominating shareholder has the power to recall the loaned shares within a specified time frame (most commonly, on three or five business days' notice), or may terminate the share lending within a specified time frame. A few provisions require that the nominating shareholder has actually recalled the loaned shares prior to the end of the relevant period.

Holding Period

All of the proxy access provisions adopted so far in 2015 provide that the nominating shareholder must own the requisite amount of shares for at least three years. A nominating shareholder is typically required to continue to own the requisite amount of shares until the nomination date, the record date and annual meeting date and, at 27 out of 62 companies (44%), is required to represent that it will, or intends to, continue to own the requisite shares for at least one year after the annual meeting.

Nominee Limit and Procedure for Selecting Candidates if Nominee Limit is Exceeded

Most companies have limited the number of board seats available to proxy access nominees to 20% of the board (32 out of 62 companies (52%)), eight of which provide for a minimum of one proxy access nominee. Companies are increasingly limiting the number of board seats available to proxy access nominees to the greater of two or 20% of the board (20 out of 62 companies (32%)). Several companies have adopted a 25% cap (10 out of 62 companies (16%)). In most cases, if the calculation of the maximum number of proxy access nominees does not result in a whole number, the maximum number of proxy access nominees that the company would be required to include in its proxy materials would be the closest whole number below the applicable percentage (e.g., 20% or 25%).

Most proxy access provisions provide that, if a vacancy occurs on the board after the nomination deadline but before the date of the annual meeting, and the board decides to reduce the size of the board in connection with the vacancy, the nominee limit would be calculated based on the reduced number of directors. Any proxy access nominee who is either subsequently withdrawn or included by the board in the proxy materials as a board-nominated candidate typically would count against the nominee limit (including in a specified number of future years). Many proxy access provisions provide that the maximum number of proxy access nominees that the company would be required to include in its proxy materials will be reduced by the number of director

candidates nominated by any shareholder pursuant to the company's advance notice provisions (21 out of 62 companies (34%)).

Any nominating shareholder that submits more than one nominee would be required to provide a ranking of its proposed nominees. If the number of proxy access nominees from all nominating shareholders exceeds the nominee limit, the highest ranking qualified person from the list proposed by each nominating shareholder, beginning with the nominating shareholder with the largest qualifying ownership and proceeding through the list of nominating shareholders in descending order of qualifying ownership, would be selected for inclusion in the proxy materials, with the process repeating until the nominee limit is reached.

Limitation on the Size of the Nominating Group

All but two companies that have adopted proxy access during 2015 have limited the number of shareholders that are permitted to comprise a nominating group. A nominating group size limit of 20 is the most common (51 out of 62 companies (82%)); however, a small number of companies have set a lower limit (e.g., 1, 5, 10 or 15; see Appendix A). Proxy access provisions often also provide that a shareholder cannot be a member of more than one nominating group. Many companies require that one group member be designated as authorized to act on behalf of all other group members.

Information Required of All Nominating Shareholders

Each nominating shareholder is typically required to provide certain information to the company, including:

- Verification of, and information regarding, the stock ownership of the shareholder as of the date of the submission and the record date for the annual meeting (including in relation to derivative positions).
- The Schedule 14N filed by the shareholder with the SEC.
- Information regarding each proxy access nominee, including biographical and stock ownership information.
- The written consent of each proxy access nominee to (1) be named in the proxy statement, (2) serve as a director if elected and (3) the public disclosure of the information provided by the shareholder regarding the proxy access nominee.
- A description of any arrangement with respect to the nomination between the shareholder and any other person.
- Any other information relating to the shareholder that is required to be disclosed pursuant to Section 14 of the Exchange Act, and the rules and regulations promulgated thereunder.
- The written consent of the shareholder to the public disclosure of the information provided to the company.

Nominating shareholders are generally permitted to include in the proxy statement a 500-word statement in support of their nominees. The company may omit any information or statement that it, in good faith, believes would violate any applicable law or regulation.

Nominating shareholders are also typically required to make certain written representations to and agreements with the company, including in relation to:

- Lack of intent to change or influence control of the company.

- Intent to maintain qualifying ownership through the annual meeting date and, at 27 out of 62 companies (44%), for one year beyond the meeting date.
- Refraining from nominating any person for election to the board other than its proxy access nominees.
- Intent to be present in person or by proxy to present its nominees at the meeting.
- Not participating in any solicitation other than that relating to its nominees or board nominees.
- Not distributing any form of proxy for the annual meeting other than the form distributed by the company.
- Complying with solicitation rules and assuming liability and providing indemnification relating to the nomination, if required.
- The accuracy and completeness of all information provided to the company.

Information Required of All Proxy Access Nominees

Each proxy access nominee is typically required to make certain written representations to and agreements with the company, including in relation to:

- Acting in accordance with his or her duties as a director under applicable law.
- Not being party to any voting agreements or commitments as a director that have not been disclosed to the company.
- Not being party to any compensatory arrangements with a person or entity other than the company in connection with such proxy access nominee's candidacy or service as a director that have not been disclosed to the company.
- Complying with applicable laws and stock exchange requirements and the company's policies and guidelines applicable to directors.
- The accuracy and completeness of all information provided to the company.

Proxy access nominees are also typically required to submit completed and signed D&O questionnaires.

Several companies have adopted a provision requiring each proxy access nominee to submit an irrevocable resignation to the company in connection with his or her nomination, which would become effective upon the board determining that certain information provided by the proxy access nominee in connection with the nomination is untrue or misleading or that the nominee or the nominating shareholder breached any obligations to the company.

Exclusion or Disqualification of Proxy Access Nominees

It is typical for proxy access provisions to permit exclusion of proxy access nominees from the company's proxy statement if the nominating shareholder (or at some companies, any shareholder) has nominated any person (or at some companies, one or more of the proxy access nominees) to the board pursuant to the company's advance notice provisions (52 out of 62 companies (84%)).

In addition, the company is typically not required to include a proxy access nominee in the company's proxy materials if any of the following apply:

- The nominee withdraws, becomes ineligible or does not receive at least 25% of the votes cast at his or her election. Such person is typically ineligible to be a proxy access nominee for the two annual meetings following such vote.
- The nominating shareholder participates in the solicitation of any nominee other than its nominees or board nominees.
- The nominee is or becomes a party to a compensatory arrangement with a person or entity other than the company in connection with such nominee's candidacy or service as a director that has not been disclosed to the company or, at 20 out of 62 companies (32%), under any circumstances, whether or not disclosed.
- The nominee is not independent under any applicable independence standards. Some companies require nominees to meet heightened standards of independence applicable to audit committee and/or compensation committee members under SEC, stock exchange and/or IRS rules.
- The election of the nominee would cause the company to violate its charter or bylaws, any stock exchange requirements or any laws, rules or regulations.
- The nominee has been an officer or director of a competitor (often as defined in Section 8 of the Clayton Antitrust Act of 1914) within the past three years.
- The nominee is the subject of a pending criminal proceeding or has been convicted in a criminal proceeding within the past 10 years.
- The nominee is subject to any order of the type specified in Rule 506(d) of Regulation D promulgated under the Securities Act.
- The nominee or the nominating shareholder has provided false or misleading information to the company or breached any obligations under the proxy access provision.

Several proxy access provisions include "creeping control" limitations which take various forms. A proxy access nominee elected by shareholders will typically count towards the proxy access nominee limit in future years (often two or three years after election). At some companies, if a nominating shareholder's nominee is elected to the board, then such nominating shareholder may not utilize proxy access for the following two annual meetings (other than with respect to the nomination of the previously elected proxy access nominee).

The board or the chairman of the annual meeting may declare a director nomination by a shareholder to be invalid, and such nomination may be disregarded, if the proxy access nominee or the nominating shareholder breaches any obligations under the proxy access provision or the nominating shareholder does not appear at the annual meeting in person or by proxy to present the nomination.

Spotlight: Limitations on the Size of the Nominating Group

Companies that have already adopted proxy access should bear in mind that shareholders may seek to modify the terms of such provisions in the future. For example, Mr. McRitchie, the proponent at Whole Foods and several other companies that have since adopted proxy access, has criticized many proxy access bylaws as embodying "proxy access lite" and has indicated that he may in the future propose "precatory or binding bylaw resolutions to try to eliminate the limitation on group participants and to address other possible issues to be discovered upon closer examination of adopted bylaws."[35] More recently, in the face of increasing adoptions of "proxy access lite" provisions, Mr. McRitchie announced that he "will be circling back to these companies to get more favorable terms."[36] Mr. McRitchie also announced that he has tightened the language in his template proxy access proposal with the goal of "avoiding proxy access lite from the start," and has begun submitting the revised template to companies that have not yet adopted proxy access provisions.[37] The template provides for at least two proxy access nominees, no limitation on the size of the nominating group and that loaned shares should count toward the ownership threshold.

The public pension funds led by New York City Comptroller Stringer have also expressed concerns about certain "unworkable" proxy access provisions adopted to date, including provisions which limit the number of shareholders who can aggregate to form a nominating group.[38]

Although untested, in light of recent comments by the Director of the SEC's Division of Corporation Finance, it seems likely that no-action relief would not be available on the "substantially implemented" basis unless the company can show that it substantially implemented the *removal of the limit* sought by the proponent.[39]

Potential Impact of Proxy Access on Corporate Governance

It remains to be seen what impact proxy access will have on corporate governance. At companies where proxy access has been adopted, boards and management may become more focused on the quality of shareholder relations, communications and engagement, in an effort to avoid a contested election against one or more proxy access nominees.

One of the benefits of the board self-determination that occurs absent a proxy contest or proxy access situation is the ability of the board to ensure that its composition is aligned with its view of what the company needs for effective oversight. This is not a simple matter given the mosaic of skill sets, experience and diversity that is needed on a board.

An elected proxy access director will owe the same fiduciary duties as the other directors, though some may view proxy access directors as potentially having an allegiance to the nominating shareholder's interests. Depending on the circumstances, however, there may be a greater risk that the proxy access director is viewed by the rest of the board as an outsider or even an adversary.

Concerns about how proxy access may impact board dynamics include:

- **Board fragmentation**. The board may become dominated by factions that are aligned with particular segments of the shareholding body rather than the shareholding body as a whole.
- **Board dysfunction**. Distrust among directors may develop and lead to board dysfunction with an associated negative impact on the quality of board oversight.

Concerns about how proxy access may impact a company in general include:

- **A higher risk of legal challenges**. Disagreement among directors may lead to a greater risk of legal challenges, including challenges in contexts that lack business judgment rule protection, subjecting transactions to heightened standards of review.

- **Joint shareholder action**. Special interest shareholders could coordinate to increase their representation on the board without the shareholding body at large understanding the potential for joint action.
- **Increased costs and distractions**. Proxy access can lead to increased costs and distractions without delivering improvements in company or board performance.
- **Potential withdrawal of existing directors**. Incumbent directors may choose to resign rather than serve alongside a particular proxy access director.

International Perspectives on Proxy Access

In considering how proxy access may impact corporate governance in the United States, it may be helpful to consider international experiences. The CFA Institute Report on Proxy Access indicates that proxy access has historically been used sparingly to elect directors in countries that have adopted proxy access, including Canada, the UK, Australia, France, Germany, the Netherlands, Norway, Switzerland and Brazil. For example, the report cites to a 2009 finding that proxy access nominations at Canadian companies are often withdrawn prior to a vote because companies are "more willing and more likely to reach agreements with investors to avoid a vote."[40]

The CFA Institute Report on Proxy Access also evaluates the relationship between company returns and proxy access elections in Canada, the UK and Australia, and states that "[t]o the extent that proxy access provides governance benefits from a policy perspective, a preliminary analysis suggests that adverse financial impacts are negligible."[41]

Practical Considerations

Notwithstanding the concerns outlined above, it appears inevitable that proxy access will soon play a larger role in corporate governance as a result of private ordering.

Proxy access will likely follow the pattern of majority voting in uncontested director elections and become common among S&P 500 companies in the next several years, assuming that institutional investors continue to campaign through shareholder proposals and the threat of shareholder proposals.

Companies have several alternatives when considering whether and when to adopt proxy access. Companies where a proxy access proposal received majority support in 2015 should consider proxy advisor policies when implementing proxy access—specifically, the likelihood of negative vote recommendations on director elections if the board has "failed to act" on a majority-supported shareholder proposal.

We expect that many companies will follow a "wait and see" approach, particularly if they have not previously received a shareholder proxy access proposal; however, the trend towards adopting proxy access without having received a shareholder proposal is accelerating. If faced with a proxy access proposal, counsel should be prepared to help the board and management consider the full range of options available given the company's circumstances.

Some companies may choose to proactively adopt a proxy access bylaw by board action or by requesting shareholder approval of a bylaw (or charter) amendment at the next annual meeting, in either case with or without a prior public commitment to adopt proxy access. This may help position the company as a governance leader—particularly if no shareholder proposal has been received—and, depending on the specific provisions, may minimize the likelihood of receiving a future shareholder proxy access proposal. A company taking this approach should ensure that it can justify any proxy access provision with thresholds that are more onerous than

3% for three years (e.g., by disclosing preferences of its shareholders as communicated to the company through engagement).

As companies are considering these alternatives, they should:

- Follow developments in this area and keep the nominating and corporate governance committee and the full board generally apprised.
- Know the preferences of their shareholder base (as evidenced in proxy voting policies and other public statements, and voting history on proxy access proposals) and engage with shareholders with respect to proxy access.
- Keep abreast of proxy advisory firm policies and guidance relating to proxy access.
- Stay apprised of the terms upon which companies are adopting proxy access.
- Review the advance notice and director qualification provisions in the bylaws and consider whether and, if so, how such provisions may be aligned with a proxy access provision if implemented. In addition, companies that have cumulative voting in place may wish to consider eliminating cumulative voting or requiring cumulative voting to be suspended if a proxy access nominee is included in the company's proxy materials.

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

Holly J. Gregory	**John P. Kelsh**	**Thomas J. Kim**	**Rebecca Grapsas**	**Claire H. Holland**
Partner	*Partner*	*Partner*	*Counsel*	*Special Counsel*
holly.gregory@sidley.com	jkelsh@sidley.com	thomas.kim@sidley.com	rebecca.grapsas@sidley.com	cholland@sidley.com
+1 212 839 5853	+1 312 853 7097	+1 202 736 8615	+1 212 839 8541	+1 312 853 7099

Sidley Corporate Governance and Executive Compensation Practice

Lawyers in Sidley's Corporate Governance and Executive Compensation practice regularly advise corporate management, boards of directors and board committees on a wide variety of corporate governance matters, including shareholder activism and engagement, fiduciary duties, board oversight responsibilities, board investigations and special committees, SEC disclosure, legal compliance, corporate responsibility, board evaluation, board and committee structures and issues arising under Sarbanes-Oxley and Dodd-Frank. Our advice relates to the procedural aspects as well as the legal consequences of corporate and securities transactions and other corporate actions, including takeover defenses, proxy contests, SEC filings and disclosure issues, stock option issues and general corporate law matters. Our broad client base allows us to provide advice regarding best practices and trends in such matters as directors' and officers' responsibilities, board and committee practices, disclosure controls and procedures, internal controls, executive compensation and other matters.