

Corporate Governance Commentary

Presented by Georgeson Inc. and Latham & Watkins LLP

Strategies For Dealing With Shareholder Proposals

With the 2009 proxy season coming upon us, many companies have already received shareholder proposals for inclusion in their proxy statements. While the SEC has given both shareholders and companies ample guidance on the no-action request process under Rule 14a-8 under the Securities Exchange Act of 1934, this *Commentary* focuses on the decision to seek no-action relief, the alternatives to submitting a no-action request and, if one should decide against submitting a no-action request (or if the request has been denied), the strategies a company should employ when negotiating a settlement or soliciting votes on the proposal.

Since much has already been written about the technical applications of the rules, we thought that it would be helpful to provide an overview of some of the initial considerations that a company should ponder when first reviewing a shareholder proposal, a few new SEC procedures that could expedite the no-action process, and steps a company should consider taking if the proposal is to be included in the company's proxy statement.

Initial Considerations

Compliance with Rules

Upon first receiving a shareholder proposal, the company or its outside

legal counsel should verify that the proposal complies with the applicable procedural rules and analyze whether there is a substantive basis for exclusion. These considerations are set forth in detail in Rule 14a-8. If a proposal is excludable for any legal reason, it usually makes sense to pursue that route through an SEC no-action letter. However, we find that many proposals are not clearly excludable due to the sophistication of the proponents and the issues presented by the proposals. Those are the circumstances where companies need to look beyond the technical requirements and consult with their counsel and proxy solicitors to determine the appropriate course of action.

Timeline for Action

Timing is critical in dealing with shareholder proposals. Most of the applicable deadlines are easy to calculate, but have significant consequences for the proposal if they are not met. As a result, it may be helpful for the company to create a timetable with all pertinent due dates under Rule 14a-8. Timing should always be monitored carefully as the company is considering and pursuing its alternatives because its strategies may change depending on where it is in the process.

"Whether or not a shareholder proposal may be excludable under Rule 14a-8, the company should consider various strategies beyond seeking a no-action request from the SEC."

New SEC No-Action Procedures

On November 7, 2008, the SEC published Staff Legal Bulletin No. 14D, which, among other things, stated that companies may now submit their no-action request letters and correspondence related to Rule 14a-8 to the SEC via e-mail at shareholderproposals@sec.gov. Companies should not submit other types of no-action requests or correspondence to this mailbox. Companies using this e-mail address to submit no-action requests should include their name and telephone number in any submission. The SEC has stated that it will process no-action requests and related correspondence received through this mailbox in the same manner as requests and correspondence submitted in paper.

The SEC has also created a new webpage where companies can find shareholder proposal no-action letters the SEC issued under Rule 14a-8 after October 1, 2007, and selected letters issued prior to October 1, 2007 (<http://www.sec.gov/divisions/corpfincf-noaction/14a-8.shtml>). Companies can also view incoming Rule 14a-8 no-action requests that the SEC is currently reviewing on this Web site.

The new SEC rules on delivery of communications and the related electronic procedures will have the effect of shortening the time in which the rest of the world and the shareholder proponent, in particular, will know that a company is seeking to exclude a proposal. A well-prepared company should be ready with its PR team (both internal and, in some cases, an external firm) to address the questions that it gets from the mainstream and shareholder press, as well as from the proponent and its other shareholders. Q&As should be prepared in advance of filing the no-action request so that the company is ready to explain in a clear and effective way its position on the issue, as well as any shareholder engagement on the issue, so as to show that the company has considered the issue thoughtfully.

A company's outside counsel and proxy solicitor can be helpful in crafting the responses to these Q&As, both from the legal perspective and from the strategic perspective of how the answers will play with a company's other shareholders, third-party opinion-makers and the shareholder press (e.g., newsletters from such organizations as the Council of Institutional Investors, RiskMetrics and Global Proxy Watch). In some cases, a proxy solicitor can provide assistance in getting the company's point of view reflected in these newsletters, which can be influential to some portions of a company's shareholder base.

Strategic Considerations

Even if a shareholder proposal may be excludable under Rule 14a-8, the company may want to consider whether it actually wants to seek a no-action request

from the SEC under Rule 14a-8 to exclude that proposal.¹ Since there is a monetary and management time cost to seeking a no-action letter, a company may decide to include the shareholder proposal in its proxy statement without seeking no-action relief.² It may also decide to pursue a no-action letter in combination with a number of other strategies. There are various strategic considerations regarding which courses of action to pursue.³

Who is the Proponent? Companies should consider who is making the proposal, their history, their other interests in the company and its industry, and the success of the proponent and their proposals with other companies.

What is the Proposal? The nature of the proposal is critical. For example, if it is one where there is either a high likelihood of success or failure, the company needs to consider how much time and expense it is willing to spend to defeat the proposal.

What is the Likelihood of Success? It is very important for the company to understand its shareholder base, the various positions of its shareholders on the issues raised by the proposal, and thus the likelihood of how its shareholders would vote on the proposal. This can be done through a combination of a company's own shareholder outreach program and work with its proxy solicitor to understand its shareholder base and to obtain the solicitor's voting projections on the proposal.

Should the Company Engage the Proponent? Engaging the shareholder proponent can be a valuable alternative, even if a company eventually concludes that it is not appropriate for it to take the requested shareholder action. It is often the case that companies, through discussions with a shareholder proponent, may succeed in getting the shareholder to withdraw its proposal. Often times, many shareholder proponents are not in for a fight but want to negotiate. Some proponents could just be using the proposal process to grab the company's attention and to discuss an entirely different issue. Usually, these other objectives would fail as a shareholder proposal and the shareholder proponent would withdraw their proposal if it is able to discuss this other agenda.

Shareholder engagement may also open the way for a company to see how it might modify its plans further to satisfy the proponent (and perhaps even learn something from a proponent's expertise in the particular area), without compromising certain principles that its management and board believe are important for the company to maintain. Engagement may also buy the company some time to further study the subject matter of the proposal with its management and board. In some cases, the proponent may agree

to withdraw the proposal for the current year while continuing the engagement and seeing what action the company takes in the coming year.

Shareholder engagement—whether at the management or board level—also enables a company to explain later to the proxy advisory firms (such as RiskMetrics (formerly ISS), Glass Lewis and Proxy Governance) and its other shareholders that it openly and honestly discussed the issue with the proponent, but that it could not come to a mutually acceptable solution without compromising important company principles. This can be particularly valuable to a company if it later talks to the proxy advisory firms and solicits its other shareholders to vote against the proponent's proposal (assuming it ends up being included in the company proxy statement).

What is the Company's Track Record? A company may not want to seek no-action relief from the SEC when it has a strong record of being pro-active in the subject matter of the shareholder proposal, such as in social and environmental issues concerning, *e.g.*, its development of "green" technology or its protection of the Internet privacy of its customers. Companies usually make this decision when they are confident that their pro-active record in the particular area (which they should detail in their proxy statements and perhaps also on their Web sites) speaks so strongly in their favor that they expect a low shareholder vote in favor of the proposal. This approach works best when a company combines it with both a strong and ongoing shareholder outreach program to explain its position to its shareholders and the proxy advisory firms.

How Important is the Issue to the Company? The company should consider, based on legal and other reasons, how important it is for the company to defeat the proposal. For example, a precatory proposal typically has far less impact on the company than a legally binding proposal. In some situations, a company may already be considering the topic of the proposal and may be close or ready to adopt the action requested by the proponent—the proposal may refine or accelerate the company's internal processes with board and management.

Should the Company Implement the Proposal? Based on business or legal considerations, a company may determine that it makes sense to implement some or all of the shareholder proponent's initiatives. This could come up in the case of certain social and environmental proposals, where, *e.g.*, a company publicly discloses the positive steps that it is taking in the area and further steps it is exploring for the future. A company may also consider making a management proposal on the same topic, but one which does not go as far as the shareholder proposal.

For example, this could come up when a shareholder proposal calls for the right of shareholders holding 10 percent of a company's outstanding stock to call special shareholders' meetings. In such cases, the company may feel that 10 percent is too low of a percentage, but that 25 or 50 percent is the right percentage, given its shareholder base and the issues faced by the company at that point in time. Any of these steps may be a good idea not only because a company's management and board believe that it is the right thing to do, but also because it can help later when the company is in the midst of its shareholder solicitation.

This initial background work gives the company helpful insight into the resources it may want to deploy in reviewing its non-legal strategic alternatives. Once the company has all of this information, it will know how much time and energy to put into trying to defeat or minimize the vote for the proposal.

Voting Considerations

If a shareholder proposal is included in a proxy statement, companies have a different set of considerations during the vote solicitation process.

Continued Negotiation. The negotiation and settlement strategies discussed above for dealing initially with a shareholder proponent may also apply if the shareholder proposal is included in a company's proxy statement. Although it is generally easier to negotiate with a proponent before this point in time, the opportunity for negotiation and settlement remains a possibility up until the company's shareholders meeting and vote.

It may be that the additional time gives a company's management and board the additional information they need to conclude that it is in the company's best interests to adopt or substantially modify its policy or practices on a particular issue. By remaining engaged with the shareholder proponent, its other shareholders, the proxy advisory firms and the shareholder press, a company will have a better chance of defeating the shareholder proposal at its annual meeting. In cases where the company has continued to engage the proponent positively, the company may even be able to seek the proponent's help in defeating the proponent's own proposal by having the proponent reach out to these other groups to explain the company's change of position.

Shareholder Solicitation Campaign. A company can work closely with its proxy solicitor to reach out to the proxy advisory firms and its shareholders to explain its position. This can range from a call from one or more members of management to an in-person meeting with both management and independent directors present. Depending on a company's shareholder base, the

shareholder outreach may vary from reaching out to only a few large institutional shareholders or to launching a full-scale call center campaign to a large group of the company's retail shareholders.

In the case of the proxy advisory firms and the company's institutional shareholders (as well as the shareholder press), a company's proxy solicitor should be very helpful in providing the right contact names and telephone numbers, as well as in helping to shape the arguments that the company should be making to the different groups. A proxy solicitor can also set up the necessary calls and meetings and provide additional background on the persons with whom the company will be engaging. While a proxy solicitor can have the discussions on behalf of the company, it is generally more effective for the company when it has one or more of its own representatives conducting those discussions directly. Depending on the circumstances, a proxy solicitor may also suggest further steps such as taking part in open webcasts sponsored by RiskMetrics or Glass Lewis, sending out additional solicitation materials to its shareholders, and/or launching a simultaneous PR campaign in the mainstream press.

Ongoing Communications. The solicitation period is a reminder of the importance of a year-round shareholder outreach program. This not only helps a company to understand (and perhaps even learn substantively more about) the issues that are of interest to its shareholders, but can also establish company-shareholder relationships that can be later called upon during the heat of a proxy solicitation. A company's proxy solicitor can help a company to establish or refine such an outreach program, which usually starts with the combined work of a company's corporate secretary and investor relations officer. A company's outside counsel can help remind the company of the legal limitations that are placed on the disclosures that a company may make in the course of its outreach program.

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Every shareholder proposal presents unique challenges and issues, including those set forth in this *Commentary* and others based on the specific circumstances. Working with experienced advisors can help companies evaluate the issues and alternatives and craft a course that makes the most sense.

Endnotes

- ¹ Should the company decide to submit a no-action request, the company or its legal counsel should refer to Rule 14a-8 and Staff Legal Bulletins (available on the SEC's Web site at <http://www.sec.gov/interp/legals.html>).
- ² For guidance on preparing the proxy statement, preparing for the annual meeting, or to learn of new shareholder proposal developments, please refer to the following Latham & Watkins LLP publications: Craig M. Garner et al., *2009 Annual Meeting Handbook*, (RR Donnelley 2008), Charles Nathan & Dennis Craythorn, *The 2009 Proxy Season and the Year of Investor Anger* (November 17, 2008), *2008 Proxy Season: New Developments and Reminders Regarding Executive Compensation Disclosures and Equity Plans* (February 11, 2008), "Say on Pay" Shareholder Advisory Votes on Executive Compensation: *The New Frontier of Corporate Governance Activism* (November 15, 2007), *A Practitioner's Guide to Shareholder Access* (October 22, 2007), "Empty Voting" and Other Fault Lines Undermining Shareholder Democracy: *The New Hunting Ground for Hedge Funds* (April 20, 2007), and *Binding By-Law Shareholder Proposals: The Next Frontier for Corporate Activists* (August 1, 2006). All of these publications and more can be found under the "Resources" tab on www.lw.com.
- ³ For recent data on the shareholder proposals submitted to and voted upon by the shareholders of the S&P 1500 companies, please refer to Georgeson's *2008 Annual Corporate Governance Review* at <http://www.georgeson.com/usa/acgr08.php>. Proposals, with their voting results, are sorted by company, proposal topic and sponsor.

If you have any questions regarding this Commentary or dealing with shareholder proposals, please contact the Georgeson Inc. representatives or Latham & Watkins LLP representatives listed below.

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