In a surprising policy reversal, the Securities and Exchange Commission temporarily suspended its ability to provide informal staff "no-action" relief to exclude shareholder proposals from annual meeting proxy statements on the basis that they directly conflict with a management proposal involving the same subject matter. Most important, this impacts the estimated 100 "proxy access" proposals expected to be submitted to companies this year (75 proposals have been submitted thus far). The nature and timing of the SEC announcement leaves companies and shareholders in a sort of governance limbo with respect to proxy access. The announcement will likely also affect other types of conflicting management and shareholder proposals such as those seeking to give the shareholders the right to call special meetings (which, like proxy access proposals, often result in conflicts between shareholders and companies regarding specific thresholds and other terms contained in the proposal).

Directly affected companies now need to tread carefully in order to avoid potentially contentious governance pitfalls with key institutional investors and proxy advisory firms. In much of the commentary issued to date by law firms and other organizations, the specter of exclusion-related litigation (regardless of who initiates it) between shareholders and companies has been raised as both sides seek to protect their interests. We will not delve into the legal/regulatory implications of various strategies for dealing with proxy access proposals, e.g., exclusion and alternative proposals. Suffice it to say that companies need to carefully weigh the benefits of ongoing legal skirmishes with shareholders, because a win in the court system doesn't guarantee a win in the court of shareholder opinion, and that fact has repercussions in an age of increasing activism. Companies not yet targeted need to stay abreast of what happens to the currently targeted companies, as we believe that the proponents intend to submit many more proxy access proposals later this year and in coming proxy seasons. And as already mentioned, the conflict issue may come into play on any number of other governance-related proxy proposals, particularly proposals involving shareholder rights to call special meetings.

**Recent Developments in Proxy Access and the "Counterproposal" Strategy**

Recently, Whole Foods was initially successful in obtaining no-action relief to exclude a proxy access resolution by including an alternative board-sponsored resolution in its upcoming proxy statement. The alternative proposal initially included higher ownership thresholds and longer holding periods (originally 9%/5 years) than the proponent’s version (3%/3 years). The SEC staff agreed with Whole Foods that the shareholder proposal conflicted with the company proposal on the same subject matter and would therefore take no action if the company excluded it.

A number of institutional investors and shareholder advocates cried foul and took the SEC
to task for enabling a “counterproposal” strategy aimed at forcing shareholders into voting for a weaker form of proxy access. Even prior to last week’s SEC reversal, Whole Foods may have reacted to this shareholder sentiment by reducing its proposed proxy access thresholds (5% ownership held continuously for 5 years). Despite this reduction, the views of shareholder advocates like the Council of Institutional Investors (CII) remained firm.

Last week, SEC Chair Mary Jo White announced that she had directed the Division of Corporate Finance Staff to review and report back to the Commission on this aspect of the shareholder proposal rules. On the same day, the SEC staff announced it would not issue further no-action rulings based on “directly conflicting management proposals” this proxy season and reversed its no-action ruling on the Whole Foods no-action relief.

What the SEC Actions Mean for Targeted Companies With Proxy Access Proposals
As discussed above, we will not opine on the legal risks and ramifications of proceeding with exclusions and alternative proposals, but we can comment on a few of these options from a proxy voting and shareholder relations perspective. Three of these options (and there are undoubtedly others) are:

- Submitting a management proposal that provides an alternative version of proxy access to the excluded shareholder proposal in the vein of the Whole Foods management proposal.
- Simply including the non-binding shareholder proposal with no management alternative.
- Including both a management and a shareholder proposal on proxy access in the same proxy statement.

Each of the above options should be carefully analyzed in terms of voting outcomes, and how companies are viewed by shareholders and likely by the proxy advisory firms with respect to corporate governance practices.

Exclusion Combined With Alternative Proxy Access Proposals
It is conceivable that the exclusion plus management proposal option could include a proxy access regime that shareholders would support. Vanguard, for example, has recently indicated likely support for the 5% ownership/3-year continuous holding threshold. Whether other of the large indexed and other investment-style equity funds would follow suit is unclear, and engagement and research would be required in order to estimate an outcome. Such alternative proposals should be carefully crafted to avoid hot-button issues that would draw opposition from institutional shareholders and proxy advisory firms.

Beyond the result of the vote on the alternative proxy access resolution, companies also need to examine whether the mere act of exclusion without SEC support might result in negative responses by shareholders even if an alternative is presented. Some shareholders have already expressed disdain for the exclusion/alternative strategy, raising the possibility of “withhold” or “against” votes in the election of director vote at the same annual meeting.

Inclusion of Shareholder Proxy Access Proposal
In this option to include only the shareholder proponent’s non-binding resolution, a critical factor in determining the outcome will be companies’ statements in response to proposals and their subsequent shareholder outreach. We believe that in most cases, companies will oppose the resolution. The success of the companies’ campaigns will largely be based on multiple factors including the perception of the companies’ corporate governance policies and practices (as articulated in their statements of opposition) and, to some extent, the performance of the companies. We are aware that some companies are considering making no recommendation and simply treating the non-binding proposal as a referendum, with an opportunity for further engagement with their shareholders on the issue. In these cases, companies’ proxy disclosure might include a discussion of risks and benefits of the proposal. This route has some precedent, although it raises the issue of whether boards should make a firm recommendation on all matters of importance to shareholders. In either case, the effectiveness of the response statement and the strategy developed for direct solicitation of shareholders would be critical.
Include Shareholder Proposal and Competing Management Proposal
Inclusion of both a non-binding shareholder and a binding or non-binding management proposal would clearly be the most difficult set of circumstances for which to project an outcome. There is limited precedent regarding situations where “dueling” management and shareholder proposals on the same subject appear in the same proxy statement. Other complicating factors include whether the management proposal is binding and the shareholder proposal is not, and what disclosure is made regarding what the company would do if both proposals are deemed to have passed. This strategy should be carefully reviewed with advisors given the seriousness of the repercussions of certain actions.
There are multiple issues to consider, such as what voting strategies institutional shareholders would employ when faced with two competing proposals where one is a binding management proposal and the other is a non-binding shareholder proposal with terms shareholders believe are more favorable. Will they vote for both, in order to ensure achieving some positive change, or will they simply support the proposal they prefer from a governance standpoint? Georgeson’s communications with various institutional shareholders indicates that there is considerable uncertainty among them on this potential voting scenario, and others simply have not yet considered such a circumstance. Clearly then, companies considering this avenue need to do their homework on what shareholders are thinking and how to approach them.

While much attention is being paid to the legal effect of last week’s SEC reversal, boards and management should also consider the governance and investor relations aspect of their responses to the proxy access issue (as well as other conflicting proposal situations, e.g., the right to call special meetings). For companies facing these proposals this season, that consideration should include in-depth analysis of voting scenarios based on feedback from shareholder engagement as well as strategic advice on the long-term impact of choices made. Other companies should be aware that the New York City Comptroller and perhaps other proponents likely plan to expand the proxy access campaign well beyond 2015, and those companies should carefully monitor the outcome of the coming season’s proxy access results, as well as developments regarding the SEC’s position on conflicting proposals on other governance issues in general.

Georgeson will be closely monitoring this development and will update clients and others accordingly.

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Account executives are also available to assist with any questions you may have, and their contact information is available here.

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