

PROXY UPDATE

December, 2011

PROXY ACCESS HAS ARRIVED

When the SEC decided not to appeal the ruling by the U.S. Court of Appeals in Washington relative to federally mandated Proxy Access, it let its previous stay on amendments to Rule 14a-8 expire, thus allowing for shareholder proposals on Proxy Access in 2012. As a result, private ordering has begun, and as of late December Proxy Access proposals have already been submitted at sixteen companies.

The current governance landscape is substantially different than five years ago when Proxy Access proposals appeared, and there is no clear standard for what constitutes an acceptable Proxy Access proposal in terms of ownership amounts and tenure. Given that there is no standard holding and timing requirements in place, it is not surprising that shareholder proponents have submitted proposals that contemplate four different Proxy Access schemes.

We would note that the results on some of these proposals may not be indicative of general shareholder sentiment on Proxy Access since some of the targets have significantly underperformed their peers and have been the public subject of governance failures.

Below is a summary of the proposals submitted to date.

United States Proxy Exchange Members

Members of The United States Proxy Exchange (“USPX”), a non-profit organization funded by individual investors, have submitted proposals at eight companies. Seven of these proposals follow the recently formulated USPX Model Shareowner Proposal for Proxy Access and are non-binding; however, the eighth proposal is binding and does not follow the USPX model. Among those submitting non-binding, USPX model proposals are well known activists Ken Steiner and John Chevedden. The USPX model is intended to be used as a starting point or as a template for holders that wish to submit access proposals, and according to the USPX, as a means “*of stimulating debate and experimentation with alternative approaches to proxy access.*” The USPX believes that proposed SEC Rule 14a-11 was anti-democratic in two respects: (1) the high ownership threshold of 3% required for nomination and (2) the “hard cap” on the total shareholders nominations at one nominee or 25% of the board.

The USPX Model proposal has two separate and distinct eligibility requirements for shareholders wishing to make nominations. The first standard for eligibility is that any party of one or more shareowners must have held 1% of the company’s securities continuously for two years. The second standard is that any party of shareowners of 100 or more must satisfy the SEC Rule 14a-8(b) requirements (must hold at least \$2,000 in market value continuously for one year). The USPX states that the first requirement is intended primarily for larger institutional shareowners, but may also qualify some individual shareowners at certain companies. The second requirement is intended for individual shareowners or a combination of a small labor or pension fund and individual holders. Through internet communications, we believe it would be fairly simple to round up 100 disgruntled eligible shareholders to join such a group.

Although USPX agrees that changes in control should be made through independent proxy solicitations and not through Proxy Access, the USPX model does not place a “hard cap” on the number of members that may be elected to the board through the Proxy Access process. Instead the proposal incorporates certain “safeguards” that they believe will make Proxy Access less attractive than an independent solicitation in cases where change in control is the objective. One “safeguard” is

that nominating groups can't act in concert and must affirm in writing that they do not have any agreements with any other groups. However, USPX states that the safeguards "*are not intended to make it impossible to achieve a change in control through Proxy Access.*"

According to a December 21 article on the USPX website, a proposal submitted by Daniel Rudewicz to KSW, Inc. does not follow the USPX Model. According to the article, the proposal is binding and has an ownership requirement of 2% that must be held for at least one year. The article did not go into detail on whether there is a cap on the number of Proxy Access directors that are allowed on the board.

Norges Bank's Binding Access Proposals

Norges Bank Investment Management (which manages the \$550 billion Norwegian Government Pension Fund) has submitted six proposals on Proxy Access. The proposals are being submitted as by-law amendments and would be binding on the Company, should they pass. In a recent Wall Street Journal article, Anne Kvam, global head of ownership policy at Norges Bank Investment Management said, "*We are an active investor, not an activist investor.*" She also noted that if boards aren't becoming more accountable to shareholders, "*...we will nominate directors. We are not planning that now; we would much rather have a good dialogue with the board.*"

According to Norges, they have targeted U.S. companies that they perceive as having corporate governance failures or unsatisfactory financial performance. The Norges proposal requires a nominating holder to own 1% or more of the Corporation's outstanding stock for a period of one year prior to the submission of the nomination. In addition, a maximum of 25% of the members of an elected board may be nominated by shareholders.

Amalgamated Bank and Public Pension Funds Proposals

Recently it came to light that Amalgamated Bank's LongView Fund filed a proposal at Hewlett Packard. A similar proposal was also filed at Nabors Industries by a group of nine public pension funds. The proposals are non-binding. Both proposals would require the nominating holder to own 3% of the stock continuously for three years. In addition, both proposals would limit the number of Proxy Access directors to no more than 25% of the board.

Council of Institutional Investors Statement on Proxy Access

In late November, the Council of Institutional Investors ("CII") issued a press release asking its membership to consider using Proxy Access in a focused and consistent manner. They note that shareholder proposals should include language that requires nominators to have a meaningful percentage ownership for a meaningful period of time. However, "meaningful" was not been defined by CII.

CII also noted that Proxy Access is a fundamental shareholder right and as such they will continue to lobby the SEC to issue a uniform standard for Proxy Access at all companies. As we move forward into 2012, it appears some holders and groups are still hoping the SEC will mandate Proxy Access at some point in the near future.

How Will Proxy Access Proposals Fare?

To give some perspective, in 2007 there were three Proxy Access proposals voted on at Hewlett Packard, UnitedHealth and Cryo-Cell International. The binding proposals at Hewlett Packard and UnitedHealth, which required 3% ownership held for at least two years, each received support from more than 40% of shares voted on the issue. The outcome on each of these proposals may have been influenced by active proxy campaigns from pension funds in support of the proposals. The proposal at Cryo-Cell, which called for 5% held for at least two years, passed receiving support from a majority of the shares voting. The proponent of that proposal was a 13% owner. Each of these proposals received a favorable recommendation from ISS and Glass Lewis.

Based on ISS' 2012 policy, as well as their previous comment letter to the SEC, it is clear they view Proxy Access as an important shareholder right and a measure of good corporate governance. We believe both ISS and Glass Lewis will be inclined to view some of the Proxy Access proposals favorably.

In reviewing recent SEC comment letters on Proxy Access it would appear that large mutual funds such as Blackrock, Vanguard and Capital Research would not be inclined to support 1% Proxy Access proposals. However, this is not to say they won't make an exception with some companies. As is often the case on certain corporate governance reform proposals, the stance from the largest mutual funds may prove to be outcome determinative.

We believe the proposals more closely modeled after proposed SEC rule 14a-11 will receive the greatest support from shareholders in 2012. And, as happened in 2007, we expect to see proxy campaigns run in support of some of these proposals.

Proxy Access in 2012 and Beyond

During the 2012 proxy season and into next fall, we expect shareholder proponents and others to study voting results, ISS and Glass Lewis recommendations, institutional voting records, and pay close attention to the companies, if any, that adopt their own Proxy Access standards this year. Additionally, as is often the case on proxy issues, we expect proponents to use the offseason to lobby major institutional shareholders, as well as ISS and Glass Lewis in support of an evolved standard, most likely designed for submission at a greater number of companies in 2013.

Following the path of majority voting and Say-on-Pay, it also seems likely that some standard of Proxy Access will gain traction with investors as the issue evolves over the next several years. We believe it is likely that Proxy Access will eventually be viewed as another fundamental shareholder right. Indeed, it is already on its way in becoming a standard that companies will be pressured to adopt.

Preemptive Company Action

Many companies already began preparations for the advent of Proxy Access once the SEC proposed Rule 14a-11. For those that haven't, they would be well advised to speak with outside counsel to sharpen governance bylaws such as advanced notice provisions and specified director qualifications.

As was recently magnified with the emergence of Say-on-Pay, companies should be aware of their shareholder profile, solidify relationships with their largest holders and have a strong sense of how these shareholders view the company's performance and governance practices.

Morrow will continue to monitor this issue and we will keep you updated throughout the proxy season. In the meantime, if you have any questions please contact your Morrow representative or call (203) 658-9400.

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