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# CUG.COMments

***A Newsletter from Chicago Underwriting Group***

**Underwriters of D&O and Professional Liability Insurance**

***In this issue …*** *we look at proxy access.*

## Background

Proxy access, generally defined as the ability of shareholders to place nominees of their choice on the ballot for board membership alongside the nominees of the company, was first mentioned in this newsletter in May 2009, which noted that the Securities and Exchange Commission (SEC) Chairman, Mary Schapiro, just a few days earlier had announced a proposed change in the Commission's rules, requiring proxy access for eligible shareholders. Following the requisite period for comments —which were numerous— the SEC moved forward to adopt the new rule (Exchange Rule 14a-11) on August 10, 2010.

The next month, and not unexpectedly, the Business Roundtable and the U.S. Chamber of Commerce petitioned the D.C. Circuit Court of Appeals for a judicial review of the rule. Implementation was therefore postponed, or stayed, until the legal challenge had been resolved. The decision of the Court was handed down on July 22, 2011, almost a year later, and it was a notable setback for the SEC, which was found to have acted "arbitrarily and capriciously" in failing to "adequately assess the economic effects" of the proposed rule, which the Court summarily vacated.

The SEC's response was to accept defeat and walk away: "The [SEC] … is not seeking a rehearing of the decision … nor will the SEC seek Supreme Court review." Mandated proxy access had been overthrown.

## Proxy access by stealth?

For supporters of proxy access there was a silver lining. In tandem with proposed Rule 14a-11 were amendments to Exchange Rule 14a-8, by which eligible shareholders were permitted to require that companies include shareholder proposals regarding proxy-access procedures in the company's proxy materials. These amendments were not part of the legal challenge to Rule 14a-11; they had survived unscathed, and duly became effective later that year. So while eligible shareholders did not get the gift of mandated proxy access, they were left with the consolation prize of a clearer path to getting proxy access put to a ballot. Taking that path is sometimes known as "private ordering."

## Four years on: the rise of private ordering

A study published on July 24, 2015 found that since the amendment to Rule 14a-8 took effect there had been around 160 proxy-access proposals submitted by shareholders. Of those, twenty-four had occurred during the 2012 proxy season —the period when proxy materials are sent out to shareholders in advance of a company's annual meeting. For the 2014-15 season this number jumped to more than 100. Much of the increase was due to the work of the New York City Comptroller, Scott M. Stringer, who submitted proxy-access proposals to 75 companies in which his organization is an investor. These proposals are part of what his office has termed the "Boardroom Accountability Project" (BAP).

## The Boardroom Accountability Project

According to a January 11, 2016 press release from Scott Stringer, of those 75 proposals, more than half have so far resulted in proxy-access bylaw enactments. For the current 2016 proxy season, Mr. Stringer has submitted 72 proposals, including 36 that were part of the original 75, and which have not yet enacted proxy access with "viable terms."

"Companies are … adopting proxy access at an astounding rate, and momentum is growing," declared Mr. Stringer, who had previously pointed out that the shareholder-eligibility criteria for nominating directors proposed by the BAP are similar to those proposed by the SEC under the ill-fated Rule 14a-11: generally at least a 3% stake held for at least three years, so only shareholders with a significant and long-term financial commitment would typically qualify. The number of director nominees sought by the BAP is typically capped at between 20 and 25 percent of the board membership, which is generally consistent with other proposals.

Mr. Stringer's observation on the pace of change is echoed by the proxy advisory firm ISS: "[Proxy] access is spreading like wildfire. In 2013, less than one half of a percent of firms in the S&P 500 Index had proxy access provisions in place; … at the end of 2015, over 20% of S&P 500 firms now have adopted proxy access provisions." Some companies are not waiting for a shareholder proposal under Rule 14a-8 before moving forward, and are enacting proxy-access measures in advance of any shareholder request, in essence voluntarily following the direction of the failed Rule 14a-11 mandate.

## Comment

What might be behind the rapid and continuing expansion of proxy-access adoption? Clearly, the efforts of Scott Stringer's Boardroom Accountability Project have played a major part, but another factor could be the almost parallel increase in shareholder activism. This newsletter discussed activist investors in May 2015, noting that gaining positions on corporate boards was frequently an activist investor's goal. Although aggressive activists do not need to follow an SEC manual in order to make demands on a targeted company, pre-emptively conceding proxy access might be one way to take some of the sting out of an activist campaign.

Notwithstanding the enthusiasm of proxy-access supporters, it is important to emphasize the distinction between vacated Rule 14a-11 and the adopted Rule 14a-8. Had 14a-11 stood, then the "3% for 3 years" large investors could have directly put their nominees for directors on the company's proxy ballot, subject to certain limitations. Shareholders would then vote directly for those nominees, alongside the company's own slate of nominees.

Instead, under Rule 14a-8, an eligible shareholder (generally owning stock valued at more than $2,000, or 1% of the securities, for at least a year) can request that the company place on the ballot a proposal to change its bylaws to allow eligible shareholders (typically those in the "3% for 3 years" category) to nominate directors for election to the board. Following a vote on the bylaw change, the company then decides how to proceed. A revealing exhibit in a report by the law firm of Weil, Gotshal & Manges shows how a majority vote in favor of bylaw change has not always immediately resulted in the company taking action.

Even after the bylaws have been changed, there still have to be director nominations from qualified shareholders, and a shareholder vote taken, probably at the following annual meeting. All this takes time —longer than it would under Rule 14a-11— yet the cause of proxy access is still much further advanced than it was just a few years ago.

Any measure aimed at a company's board of directors will generally, by definition, eventually impact D&O insurance to some degree. How much of an impact remains to be seen; for company executives and their major shareholders, these are largely unchartered waters.❖

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For more information, contact:
info@cug.com
T:  312.750.8800 | F:  312.750.8965

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