

February 2017

PROXY ACCESS BY PRIVATE ORDERING

Forward

This report provides a snapshot of proxy access bylaws at 347 companies collected by Covington & Burling as of Dec. 31, 2016. Proxy access is a mechanism that lets shareowners place their nominees for director in a company's proxy materials. This is important because it enables the owners of a company to avoid the cost of waging a separate proxy contest when they are dissatisfied with the performance of a corporate board and want to run their own candidates for election.

The Securities and Exchange Commission (SEC) first considered the idea in 1942, but it wasn't until 2003 that the commission proposed a [rule](#) to institute proxy access on a market-wide basis. Although the commission ultimately withdrew the 2003 proposal, the Dodd-Frank Act of 2010 granted the SEC explicit authority to adopt a proxy access rule, which the commission [did](#) that same year. A federal appeals court later [struck down](#) the rule as "arbitrary and capricious." But the court's action left in place the right of shareholders to file their own resolutions requesting proxy access, and companies retained the right to independently adopt proxy access through "private ordering" by amending their bylaws.

2015 marked a major turning point for proxy access. The prime catalyst was a non-binding proxy access shareholder resolution [campaign](#) led by the New York City Comptroller on behalf of five New York City pension funds, joined by CalPERS, CalSTRS and others. A favorable SEC review of the proper scope of companies' ability to exclude shareholder proposals from proxy materials helped too. In 2014, just 15 shareholder proposals requesting proxy access went to a vote and only four passed. By contrast, in 2015 and again in 2016, more than 80 such proposals went to a vote, and shareholders approved more than half. Faced with this evidence of substantial shareholder support, many companies adopted proxy access.

This report summarizes key provisions in proxy access bylaws as of Dec. 31, 2016. The report aims to assist both companies contemplating adding proxy access to their bylaws and investors making voting decisions on proxy access proposals. Although these early adopters represent 11 percent of the Russell 3000, they constitute more than half of the index's total market capitalization, and about half of the S&P 500 now have proxy access bylaws. The provisions these companies put in their bylaws will likely influence other companies' future decisions on how best to implement proxy access. CII's position on certain proxy access provisions is outlined in its August 2015 guide, [Proxy Access: Best Practices](#).

Ownership and Holding Period Thresholds

Companies have converged on proxy access provisions that define the ownership threshold and minimum holding period before the nominator may exercise proxy access. Ninety-seven percent of proxy access bylaws have embraced the 3 percent ownership threshold, meaning that a shareholder, or group of shareholders, seeking to nominate a director via proxy access must own at least 3 percent of outstanding shares. Several companies have reduced their ownership requirement from 5 percent to 3 percent; examples include Arch Coal, BorgWarner, Cabot Oil & Gas, CF Industries, Flowserve, HCP, Marathon Oil, Noble Energy, New York Community Bancorp, NVR, Oshkosh, Priceline Group and SBA Communications.

Simply acquiring the number of shares necessary to reach the ownership threshold does not guarantee compliance, as illustrated in November 2016 during the first attempt to utilize proxy access. Gamco Investors had sought to nominate one candidate at National Fuel Gas (NFG). The investor withdrew its candidate after NFG said that Gamco's shares were not acquired according to the method prescribed in the bylaws; specifically, without intent to change or influence control of the company. (Gamco had previously sought a spin-off at NFG, and Gamco's 13D filings indicated a potential to influence or change control.)

Ninety-nine percent of proxy access bylaws explicitly base ownership on net-long holdings, and 91 percent explicitly permit loaned shares to count toward the requirement. Typically, the bylaw specifies that loaned shares must be able to be recalled within five business days' notice. Companies including CF Industries, Hasbro and Priceline Group have amended their bylaws to follow the prevailing practice on loaned shares.

Ninety-eight percent of companies adopting proxy access opt for a three-year holding period, meaning a shareholder, or group of shareholders, seeking to nominate a director via proxy access must comply with the minimum stock ownership requirement for three years preceding the nomination. Similarly, 99 percent of companies require the nominator to hold the minimum shares through the election. Thirty-one percent require the nominator to state whether it intends to continue to own the minimum required shares for at least one year following the meeting. Just five companies (Boyd Gaming, CenturyLink, FirstMerit LSB Industries and TCF Financial) are known to require such continued ownership.

Proxy access bylaws deviating from the "3 and 3" model are increasingly rare. None of the 347 bylaws examined for this report feature a holding period greater than three years.

As shown in Table 1, the number of public companies known to have ownership requirements higher than 3 percent is down to seven.

Table 1: Unusual ownership requirements

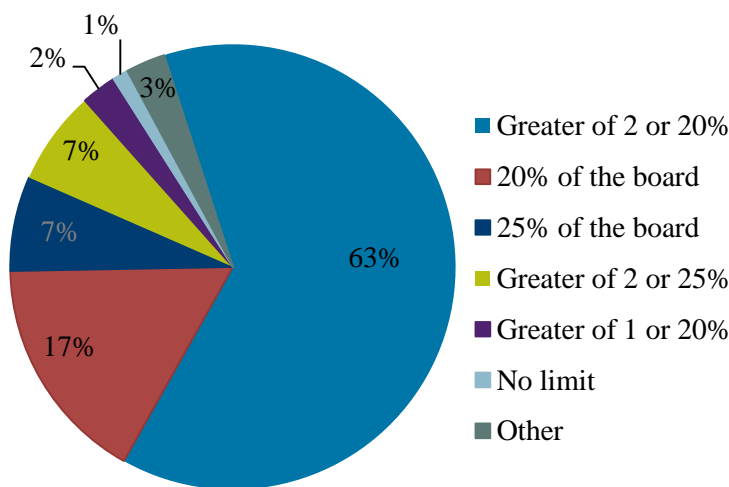
Proxy Access bylaw	Ownership requirement	Holding requirement
Hooper Holmes (2/16/10) KSW (1/5/12) (now private) LSB Industries (8/20/09) Panhandle Oil & Gas (12/11/13)	5%	One year
Nabors Industries (4/4/14) VCA (10/29/15)	5%	Three years
Covanta Holding (3/1/04) Emcore (8/7/08)	20%	No holding period specified

Maximum board seats available through proxy access

More than four-fifths of companies adopting proxy access bar access-nominated directors from generally constituting more than 20 percent of the board; this includes 17 percent with a pure 20 percent cap; 64 percent with a cap set at the greater of two directors or 20 percent; and 3 percent with a cap set at the greater of one director or 20 percent. Companies including Walt Disney and United Natural Foods amended their caps from a flat 20 percent to most common practice: the greater of two directors or 20 percent of the board.

Examples of unusual caps, relative to prevailing practice, include Panhandle Oil & Gas, which permits no more than one access director per year, and LSB Industries, which follows Panhandle’s approach but combines it with a 25-percent-of-the-board cap.

Graph 1: Board caps



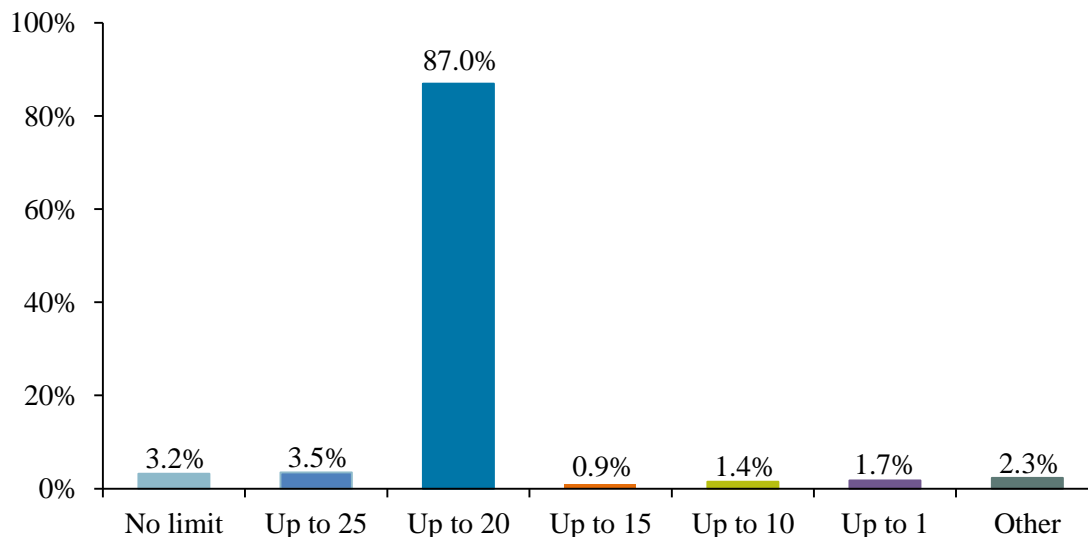
Board nominees previously

elected via proxy access do not necessarily count against the maximum. The most common approach (49 percent of all proxy access bylaws) is to count nominees against the maximum only if they were elected through proxy access within the past two years. The second most popular approach (13 percent of all proxy access bylaws) is to count those elected through proxy access within the past three years.

Shareholder Aggregation Limits

As shown in the graph below, 87 percent of companies with proxy access specify that no more than 20 shareholders may aggregate their holdings to meet the ownership requirement necessary to nominate a board candidate. Just 11 companies (3 percent) refer to a “group” of shareholders without specifying any limit.

Graph 2: Aggregation Limits



Ninety-two percent of all proxy access bylaws generally provide that families of affiliated funds count as one shareholder for the purpose of the aggregation limit. Typically, bylaws will count families of funds as one if they meet one or more of the following standards:

- Group of funds under common management and investment control (found in 84 percent of proxy access bylaws)
- Group of funds that are part of the same family of funds or sponsored by the same employer (61 percent)
- Group of investment companies as defined in the Investment Company Act of 1940 (56 percent)

Sixteen companies (5 percent) set aggregation limits below 20 shareholders. Three companies permit up to 15 shareholders to combine their shares, five permit up to 10 and one allows up to five. Three companies bar multi-shareholder aggregation altogether, while three others do essentially the same by permitting aggregation only with affiliates of the same shareholder.

Notably, only one of these 16 companies adopted its bylaw after 2015; Westmoreland Coal sets the limit at 10 unless the company's market cap rises above \$1 billion, at which point the limit would increase to 25.

A handful of companies have relaxed their aggregation limits. Regency Centers went from a maximum of one shareholder to 20; Cabot Oil & Gas and New York Community Bancorp doubled their maximums of 10 shareholders to 20; Borgwarner and HCP both went from a maximum of 10 to 25; Noble Energy eased its threshold from 20 to 25.

Some companies have eliminated their aggregation limits altogether. SBA Communications originally had a limit of 10; Cloud Peak Energy and Priceline Group initially had set the cap at 20.

Restrictions on Re-nomination

Provisions barring re-nomination of access candidates, sometimes referred to as “lock-out” provisions, are routinely found in proxy access bylaws; 82 percent of proxy access bylaws have some type of re-nomination constraint.

The most common re-nomination restrictions are:

- Nominees who fail to receive 25 percent of votes or withdraw cannot be nominated again for two years (53 percent of all proxy access bylaws)
- Nominees who withdraw cannot be nominated again for two years (13 percent)
- Nominees who fail to receive 20 percent of votes or withdraw cannot be nominated again for two years (6 percent)
- Nominees who fail to receive 10 percent of votes or withdraw cannot be nominated again for two years (4 percent)

Table 2: Unusually stringent re-nomination restrictions

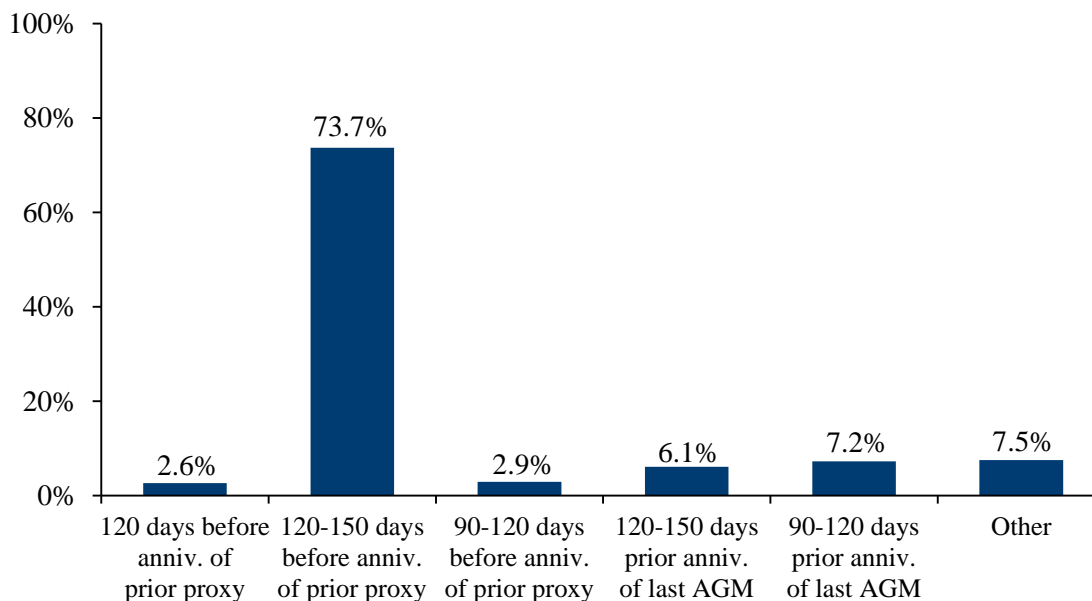
Proxy access bylaw	Re-nomination restriction
LSB Industries (8/20/09) Panhandle Oil & Gas (12/11/13)	Nominees who fail to receive 50% of votes or withdraw cannot be nominated the next year
Boyd Gaming (10/20/16)	Nominees who fail to receive 33% of votes or withdraw cannot be nominated for two years
Baxter (12/18/15) Costco Wholesale (9/26/16) United Rentals (9/8/16)	Nominees who fail to receive 25% of votes or withdraw cannot be nominated for three years

Although they are meant to reduce the incidence of nuisance candidates, restrictions on re-nomination may have unintended consequences including barring for re-nomination candidates with significant levels of shareholder support. Particularly with larger boards, it is not uncommon for a given nominee, whether management-backed or shareholder-backed, to win a seat with nominally low support. Attuned to investor concerns, some companies are modifying their policies. For example, L-3 Communications and Microsoft reduced their re-nomination thresholds from 25 to 15 percent. Other companies, including Qualcomm, Apple, Oshkosh and Cheniere Energy eliminated their re-nomination thresholds altogether. Most recently, SBA Communications went from 25 to 20 percent.

Advance notice requirements

All proxy access bylaws reviewed for this report include notice requirements for utilizing proxy access. Seventy-nine percent of proxy access bylaws tie the advance notice requirement to the first anniversary of the mailing date of the previous year's proxy statement, while 13 percent base their advance notice requirement on the anniversary of the previous annual meeting. As shown in the graph on page 8, by far the most popular notice period is 120-150 days before the first anniversary of the mailing of the proxy statement for the previous year's annual meeting.

Graph 3: Advance notice requirements for proxy access



Concurrent proxy contests

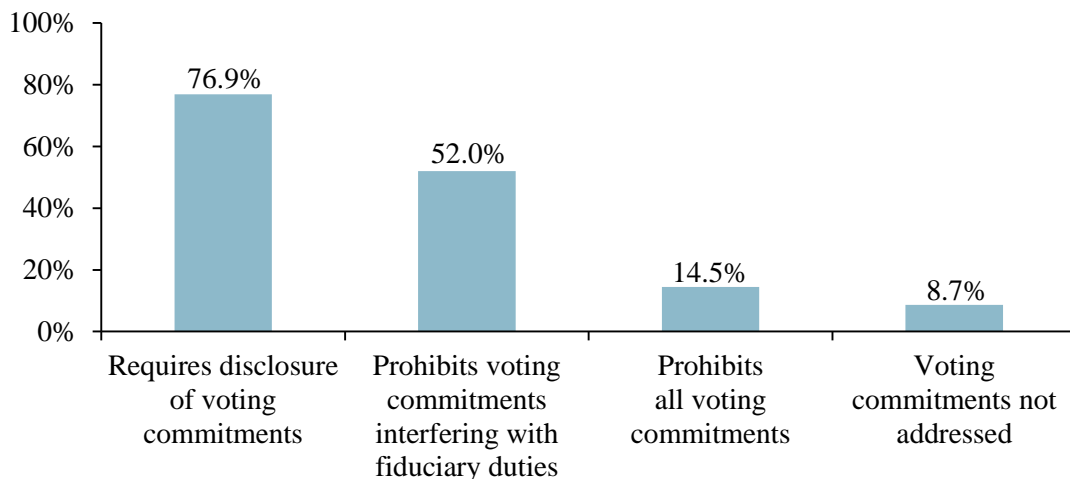
Eighty-nine percent of all proxy access bylaws allow companies to omit an access candidate if the nominator is also waging a proxy contest with a different candidate on the dissident card. Four percent of access bylaws grant similar discretion if the nominator wages a proxy contest, regardless of who is on the dissident card. Four percent of access bylaws bar the use of proxy access altogether if any shareholder is waging a proxy contest.

Some bylaws include language protecting the ability of the nominator to run at least one proxy access candidate during a proxy contest. Examples include CVS Health, Express Scripts Holding, Salesforce.com, Noble Energy, Textron and WEC Energy.

Voting commitments

Voting commitments generally bind an individual (in this case, a proxy access director, if elected) to vote in accordance with the nominator or some other affiliate. Ninety-one percent of proxy access bylaws address voting commitments in some way. As shown on page 9, a total of 77 percent of all proxy access bylaws mandate disclosure of any voting commitment. Fifty-two percent bar voting commitments that would interfere with fiduciary duties, while 15 percent prohibit voting commitments of any kind.

Graph 4: Voting commitments



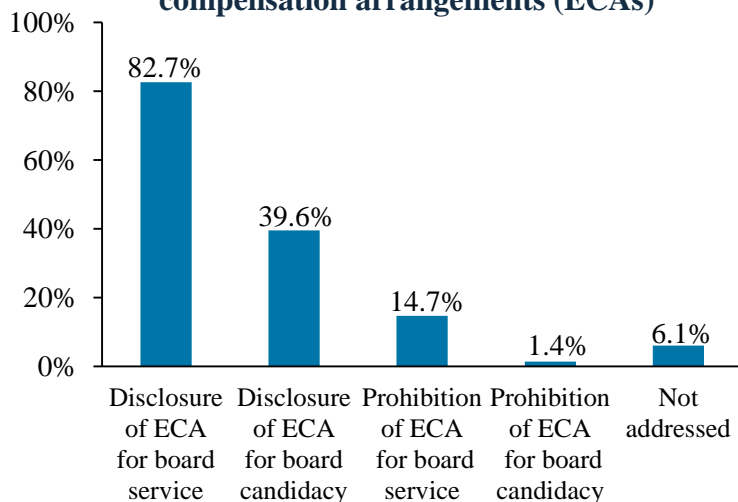
External compensation arrangements

Proxy access bylaws address compensation derived from sources other than the company, such as the nominating shareholder, in four primary ways. Eighty-three percent of proxy access bylaws require disclosure of any external compensation arrangement relating to service or actions as a director. Forty percent require disclosure of external compensation arrangements related to the nominee’s candidacy.

Other approaches go beyond transparency by prohibiting such arrangements. Fifteen percent of proxy access bylaws bar compensation arrangements for board service with access candidates, or give the company the discretion to exclude such candidates from the proxy. One percent bar compensation arrangements

for board candidacy or give the company the discretion to exclude such candidates from the proxy. Some companies, including Honeywell International and Monsanto, initially prohibited such arrangements, but subsequently revised their bylaws to just require disclosure.

Graph 5: Approaches to external compensation arrangements (ECAs)



Conclusion

This report does not address all provisions found in proxy access bylaws, including some that may render the entire mechanism useless. Proxy access, by general consensus, has included limitations that make the bylaws complicated. Reliance on private ordering (rather than a more standardized approach envisaged by the SEC in 2010) has meant that this area is even more complex, with the potential for various creative ways to block or frustrate what shareowners would see as legitimate uses of the mechanism. For example, some remarkably broad provisions require a nominating shareholder to file with the SEC anytime it communicates with another shareholder, regardless of whether that communication triggers a filing requirement under the SEC's own regulations. CII is monitoring these and other onerous provisions, and intends to release an update to its 2015 Best Practices document in the second half of 2017.

As the number of companies adopting proxy access continues to grow, and early adopters re-evaluate bylaws already in place, boards across the market are giving careful consideration to every contemplated provision's practical effect, both intended and unintended. Does the provision help ensure an orderly and reasonable process for long-term holders to put the mechanism to work? Or does the provision exist primarily to chill (or entirely prevent) the use of proxy access? Investors expect boards to tackle these questions forthrightly, keep the investor's perspective in mind, and exercise responsible discretion. By doing so, they not only mitigate the distractions of litigation, "fix-it" resolutions and emboldened support for a uniform rule; they also uphold their fiduciary duty to serve the company's best interest.

Appendix 1: Proxy Access Models at a Glance

	Prevailing practice by private ordering	2010 SEC rule (vacated)
Low director support a prerequisite for access	No	No
Min. ownership requirement	3%	3%
Min. holding period	3 years	3 years
Aggregation limit	20 shareholders	No aggregation limit
Max. proportion of the board subject to proxy access	Greater of 2 directors or 20% of the board	Greater of one director or 25% of the board
Re-nomination restriction	Failure to obtain 25% locks-out access nominee from running again for two years	None
Advance notice to utilize proxy access	120-150 days before first anniversary of mailing of last year's proxy	120-150 days before first anniversary of mailing of last year's proxy
Concurrent proxy contests	Company may omit access candidate if nominator runs a different candidate on a dissident card	Permitted
Disclosure of voting commitments	Yes	No
Disclosure of external compensation arrangements	Yes	No