

Spotlight on Shareholder Proposals: Declassification - June 2011

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This is the first of a series of posts to discuss key shareholder proposals during proxy season 2011.

While ISS reports that 39% of S&P 500 companies continue to have staggered boards, shareholder proposals requesting that the board of directors be elected annually continue to receive the highest level of support of any shareholder proposals. As of early June, 39 proposals received more than majority support, averaging 73%, while only 5 failed. Many proposals never reach shareholder vote as companies, recognizing the likelihood of strong support for the proposal, negotiate for withdrawal by agreeing to take action. For example, eBay agreed to conduct a review of declassification within 6 months.

This year, a joint effort by the Florida State Board of Administration (FSBA) and the Nathan Cummings Foundation resulted in the submission of proposals at 14 S&P 500 companies. Other proponents of declassification proposals include prolific retail activists John Chevedden, Ken Steiner and Gerald Armstrong. McDonald's and Western Union turned to the SEC for relief, arguing that the proposals violate Rule 14a-8(i)(8) because they prevent directors from completing their elected terms. The SEC staff agreed, but allowed the proponents to modify the proposals to provide that the unexpired terms of directors elected at or prior to the 2011 annual meeting would not be affected. Both companies ultimately included the revised proposals in their proxy statements. McDonald's filed additional soliciting materials emphasizing that good governance is not "one size fits all," but over 77% of shareholders nonetheless voted "for" the proposal.

As a result of the continuing drumbeat of declassification shareholder proposals over the years, over 50 companies submitted management proposals to amend their governance documents to permit annual board elections in their proxy statements this year. Ironically, some management proposals do not succeed, particularly where charter amendments require more than a simple majority to pass. At Eli Lilly, the company failed in its fifth consecutive effort to receive the requisite more than 80% outstanding shares in support.

Most management proposals phase-in annual elections after all board members have completed their elected terms. Visa adopted an unusual declassification resignation policy, contingent on shareholder approval of its bylaws, such that directors with unexpired terms tendered their resignations and the entire board will be elected on an annual basis next year.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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