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SEC Proposes New Rule Mandating Proxy Access

Introduction

Yesterday, the U.S. Securities and Exchange Commission proposed a new proxy rule – Rule 14a-11 – that would provide shareholders meeting certain eligibility standards with access to corporate proxy materials for their nominees for election as directors. Other proposed changes to the proxy rules would allow shareholders to include in company proxy materials proposals to amend the company's governing documents concerning director nomination procedures or to impose specific disclosure requirements relating to shareholder nominations. The Commission voted in favor of proposing the rule changes by a 3-2 majority. Chairman Mary L. Schapiro and Commissioners Elisse B. Walter and Luis A. Aguilar voted in favor of issuing the proposal for public comment, while Commissioners Kathleen L. Casey and Troy A. Paredes voted against the proposal.[1]

This memorandum is based upon statements made and materials provided at yesterday's open meeting of the Commission. The proposing release is not available at the time of writing. Note that final rules will be adopted only after a 60-day comment period dated from publication of the proposal in the Federal Register. It is expected that final rules to implement proxy access are likely to be adopted in time to apply to annual meetings during the 2010 proxy season.

Overview Of Proxy Access Proposal

Proposed New Rule 14a-11

As proposed, a new Rule 14a-11 would provide that a shareholder (or group of shareholders) may include in a company's proxy materials nominees for up to 25% of the company's board seats (or a minimum of one director) if the following criteria are satisfied:

- Neither state law nor the company's governing documents prohibit shareholders of the company from nominating candidates for election to the board of directors;
- The shareholder or shareholder group owns a certain minimum percentage of the shares entitled to be voted in the election of directors (the "voting securities"); the minimum percentage changes with the size and reporting status of the company.
  - "Large accelerated filer" (a company with worldwide market value of $700 million or more) or registered investment company with net assets of $700 million or more – 1% of voting securities;
  - "Accelerated filer" (a company with worldwide market value of $75 million or more but less than $700 million) or registered investment company with net assets of $75 million or more but less than $700 million – 3% of voting securities;

  - "Non-accelerated filer" (a company with worldwide market value of less than $75 million) or registered investment company with net assets of less than $75 million – 5% of voting securities;
  - Shareholders would be able to aggregate holdings to meet applicable thresholds, pursuant to proposed exemptive provisions under the proxy and beneficial ownership reporting rules.
- The shareholder or group has owned the voting securities for at least one year prior to the date notice is provided to the company of the intent to submit nominees for inclusion in the company's proxy materials;
- The shareholder or group discloses to the company, and files with the Commission pursuant to a new Schedule 14N, a statement of its intent to nominate candidates for election to the board and include information about such candidates in the company's proxy materials, and also discloses in this Schedule:
  - Representations relating to the shareholder or group's eligibility to nominate candidates for election to the board pursuant to Rule 14a-11, including but not limited to ownership of the requisite amount and percentage of securities by the nominating shareholder or group for the minimum one-year holding period and the intent to continue to hold the voting securities until the date of the meeting at which shareholders will vote on the election of directors;
  - A certification that the shareholder or group is not seeking to change the control of the company or gain more than minority representation on the company's board of directors;
  - Information about the nominating shareholder or group and the nominees themselves, similar to the disclosure currently required in a contested election, including but not limited to disclosure of any substantial interests of the shareholder or group in the election of directors, the amount of securities owned beneficially and of record by the shareholder or group (including any related indebtedness), any criminal convictions of the shareholder or group, details of stock trades by the shareholder or group in last past two years, biographical information about the nominee(s) and whether the shareholder or group (or any associate of the shareholder or group) has any arrangement or understanding with any person with respect to future employment by the company or its affiliates or future transactions to which the company or its affiliates may be a party;
  - The nominating shareholder or group would be liable under a new provision of Rule 14a-9 for any false or misleading statements contained in information provided to the company that is then included in the company's proxy materials, without concomitant liability exposure for the company absent knowledge of such falsehood;
- The candidate(s) nominated by a shareholder or group must satisfy the director independence standards set forth in the national securities exchange listing standards that apply to the company, and the person's candidacy or board membership must not violate applicable law or regulation; and
- The shareholder or group must have no direct or indirect agreement with the company regarding the nomination.

In the event that the company receives more shareholder nominees than it is required to include in its proxy materials, the company is only required to include in its proxy materials the nominees of the shareholder or group which first provides timely notice to the company on Schedule 14N.

The proposal clarifies that a shareholder or group will not lose eligibility to file abbreviated beneficial ownership reports as a passive investor pursuant to Schedule 13G, solely as a result of making a nomination, soliciting in favor of a nominee or having a nominee elected to the board under the proposed new rules. In addition, the proposal includes new proxy exemptions allowing solicitation by shareholders seeking to form a shareholder group for the purpose of nominating director candidates, and soliciting in favor of a nominee.

Proposed Amendments to Rule 14a-8(i)(8)

Currently, Rule 14a-8(i)(8) permits companies to exclude shareholder proposals that "relate to an election." The Commission also proposed amendments to this rule that would permit shareholders to include in a company's proxy materials proposals to amend or request amendment of the company's governing documents concerning nomination procedures or other disclosure provisions relating to shareholder nominations, provided that such provisions do not conflict with proposed Rule 14a-11 and are otherwise not excludable under Rule 14a-8 (e.g., because violative of state law). A shareholder bringing a proposal under amended Rule 14a-8(i)(8) would be required to meet the eligibility requirements set forth in Rule 14a-8.

The proxy access proposals approved by the Commission yesterday are part of the ambitious near-term agenda of proxy access and disclosure reforms, coupled with increased market supervision to be exercised through both the rulemaking and enforcement processes, discussed by Chairman Schapiro in a speech delivered on April 6, 2009.[2] While efforts to grant shareholders access to corporate proxy materials have been made by the Commission several times in the past,[3] this proposal dovetails in some respects with recent legislative developments and may be more likely to be adopted than previous proposals, given the current political environment and renewed emphasis on corporate governance reforms in the wake of the financial crisis.

Related Legislative Developments

Proxy access has also been the focus of legislative efforts this year at the state and federal level. On May 19, 2009, Senator Charles Schumer introduced a bill that proposes to, among other things, amend the Securities Exchange Act of 1934 to add a new Section 14A that, among other things, explicitly confirms the authority of the Commission to establish rules "relating to the use by shareholders of proxy solicitation materials supplied by the issuer for the purpose of nominating individuals to membership on the board of directors of an issuer," provided that such shareholder or group has beneficially owned an aggregate of not less than 1% of the voting securities of the company for at least the two-year period preceding the date of the next scheduled annual meeting of the company.[4]

Moreover, on April 10, 2009, the governor of Delaware signed into law new legislation permitting, but not requiring, Delaware companies to adopt bylaws that would provide for shareholder access to company proxy materials for the purpose of proposing director nominees pursuant to the procedures and conditions set forth in such bylaws (Section 112), and for the reimbursement of expenses incurred by the nominating shareholder in soliciting proxies

(Section 113). Such bylaws can be adopted either by the company's board of directors or nominating shareholders. Bylaws adopted under new Section 112 of the Delaware General Corporation Law (which becomes effective August 1, 2009) may include procedures and conditions under which a company soliciting proxies for the election of director nominees would also be required to include in its proxy materials nominees submitted by shareholders.[5]

The Proxy Access Debate

Whether and under what circumstances shareholders should be able to use company proxy materials to solicit votes for shareholder nominees has been a matter of significant debate since 2003, when the Commission first proposed a limited right of access. While the Commission did not act on this proposal, access has remained a subject of intense interest, with repeated calls by supporters that companies on their own provide, or be required by the SEC to provide, access.

Access advocates are of the view that proxy access will improve corporate governance by promoting greater director accountability to shareholders.[6] They express dissatisfaction with the effectiveness of the alternatives currently available to shareholders who wish to effect a change in the composition of a board of directors. Currently, shareholders can, as a general matter, recommend director candidates for nomination by a company's board of directors, can nominate candidates and can solicit votes in support of their nominees. However, in order to solicit other shareholders on a widespread basis for support of its nominee a shareholder must prepare and disseminate to shareholders at its own expense a proxy statement and proxy card, which can require substantial expenditures. Advocates argue that access procedures, by requiring companies to include shareholder nominees in the proxy card and proxy statement distributed by the company, will make it practicable for shareholders to participate in the nomination and election process to a much greater degree.

Chairman Schapiro, together with Commissioners Walter and Aguilar, expressed support for this view at yesterday's meeting. According to the Chairman:

> I believe that the most effective means of providing accountability — in a way that is both cost effective and timely — is to ensure that shareholders have a meaningful opportunity to effectuate the rights that they already have under state law to nominate directors. Under the proposal before us today, shareholders who otherwise have the right to nominate directors at a shareholder meeting will be able to have their nominees included in the company proxy ballot that is sent to all voters. Given the reality of how the proxy process works, this would turn what would otherwise be a somewhat illusory right to nominate into something that is real — and has a real chance of holding boards of directors accountable to company owners.[7]

Those opposing shareholder access[8] to company proxy materials, on the other hand, argue that such access would be "terribly disruptive to the corporate governance process,"[9] and would facilitate special interest directors, polarize the boardroom, hamper a company's ability to attract and retain quality directors and spawn numerous costly election contests, imposing costs on companies that all shareholders would be required to bear even where the proponent of a nominee is not prepared itself to pay the costs of soliciting for its nominees. Opponents of shareholder access have also expressed concern that, by bypassing a company's nominating committee,

access would diminish the board's fiduciary role and its ability to protect the interests of all shareholders and may result in board composition that will frustrate satisfaction of corporate governance listing standards. Commissioners Casey and Paredes raised similar concerns during yesterday's meeting, and also expressed reservations regarding the Commission's authority to regulate corporate governance by imposing access.

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If you have any questions on these matters, please do not hesitate to speak with your regular contact at Weil, Gotshal & Manges LLP or members of the Firm's Public Company Advisory Group: Howard B. Dicker, howard.dicker@weil.com, 212-310-8858; Cathy Dixon, cathy.dixon@weil.com, 202-682-7147; Holly J. Gregory, holly.gregory@weil.com, 212-310-8038; P.J. Himelfarb, pj.himelfarb@weil.com, 202-682-7197; Robert L. Messineo, robert.messineo@weil.com, 212-310-8835; and Ellen J. Odoner, ellen.odoner@weil.com, 212-310-8438.

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ENDNOTES

[1] Chairman Schapiro and Commissioners Walter and Aguilar voted in favor of issuing the proposal for public comment on the basis that proxy access will provide shareholders with a meaningful right to nominate directors. Commissioners Casey and Paredes voted against the proposal, predominantly on the basis that corporate governance issues such as providing shareholders access to company proxy materials should be a matter of state law. In addition, both Commissioners Casey and Paredes expressed a preference for amending Rule 14a-8 to permit shareholder proposals to amend or requesting the amendment of a company's governing documents insofar as they relate to nomination rights or procedures. Chairman Schapiro's speech is available at http://www.sec.gov/news/speech/2009/spch052009mls.htm. Commissioner Walter's speech is available at http://www.sec.gov/news/speech/2009/spch052009ebw.htm. Commissioner Aguilar's speech is available at http://www.sec.gov/news/speech/2009/spch052009laa.htm. Commissioner Paredes' speech is available at http://www.sec.gov/news/speech/2009/spch052009tap.htm. Commissioner Casey's speech is not available at the time of writing.

[2] For further background information concerning the Commission's near-term agenda, we have made available on our website a summary and discussion of Chairman Schapiro's speech. *See* http://www.weil.com/sec-regulatory-agenda/.

[3] The Commission addressed the issue of shareholder access in 1942, when it solicited comments on various staff proposals for revisions to the proxy rules, including a proposal to provide "minority stockholders . . . an opportunity to use the management's proxy material in support of their own nominees for directorships." Release No. 34-3347 (December 18, 1942). Moreover, in 1977, the Commission solicited comments on proxy access at hearings held as part of a broad re-examination of its proxy solicitation rules, but did not ultimately propose a proxy access rule. *See* Release No. 34-13482 (April 28, 1977); Release No. 34-13901 (August 29, 1977); *see also* Task Force on Corporate Accountability, Staff Report on Corporate Accountability (September 4, 1980) (printed for the use of Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess.). In addition, the Commission briefly turned its attention once again to the shareholder access issue in 1992 in connection with amendments to the bona fide nominee rules contained in Exchange Act Rule 14a-4, but declined to adopt a shareholder access rule. *See* Release No. 34-31326 (October 16, 1992). Most notably, in 2003, the Commission proposed amendments to its proxy rules that would have enabled shareholders, under certain circumstances, to present candidates for election as directors, using the company's proxy materials and at the company's expense. *See* Release No. 34-48626 (October 14, 2003). The rule proposals were intended to increase shareholder participation in the director selection process, as was advocated in a July 2003 Commission staff report. *See* Commission Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors (July 15, 2003). Subject to certain limitations, the proposed rule amendments would have required a company to include in its proxy materials specified information concerning shareholder nominees, and also to provide on the company's proxy card a means for voting in favor of such nominees. *See* Release No. 34-48626 (October 14, 2003). The Commission, however, took no action on the proposed rule following the comment period. Most recently, in 2007, the Commission put forth two conflicting shareholder access proposals, one which would have under certain circumstances, granted shareholders the right to require a company to *include* in its proxy materials a proposal to adopt a binding bylaw entitling shareholders to access company proxy materials (*see* Release No. 34-56160 (July 27, 2007)), and the other which would have granted companies the ability to *exclude* shareholder access proposals from company proxy materials submitted under Rule 14a-8. Under the latter proposal, a shareholder sponsoring any such proposal would have had to do so by soliciting shareholders on its own proxy statement. *See* Release No. 34-56161 (July 27, 2007). Specifically, the proposal (if adopted) would have confirmed the Commission staff's long-standing interpretive position that Rule 14a-8(i)(8), which permits companies to exclude shareholder proposals relating to the election of directors, applies to shareholder access proposals. This interpretation was invalidated on administrative law grounds in September 2006 by the U.S. Court of Appeals for the Second Circuit, in *AFSCME v. AIG*, 462 F. 3d 121 (2d Cir. 2006). The Second Circuit

held that the interpretation, articulated by the Commission staff in no-action letters starting in 1990, was not consistent with the explanation for the "director election exclusion" given by the Commission when it last revised the exclusion in 1976 and that no reasons had been provided for the change in interpretation in 1990 nor had the interpretation been subject to any notice or comment procedure. This decision, which expressed no opinion as to the merits of access proposals or how they should be treated under Rule 14a-8, led to confusion with respect to the administration of the rule. After the decision, a few shareholder access proposals were submitted under Rule 14a-8 for the 2007 proxy season. The companies receiving these proposals sought no-action relief from the Commission's staff based on the director election exclusion, arguing that the Second Circuit's decision was not binding precedent in their jurisdiction. The staff responded to the requests with a "no view" position as to the jurisdictional issue, leaving the companies on their own to decide whether or not to include the proposals. In December 2007 the SEC codified an amendment to Rule 14a-8 to clarify that a company could exclude a proxy access bylaw proposal from its proxy materials under Rule 14a-8(i)(8). *See* Release No. 34-56914 (December 6. 2007).

[4] Shareholder Bill of Rights Act, S. 1074, 111th Cong., 1st Sess. (2009).

[5] For a detailed discussion of these amendments, *see* http://www.weil.com/news/pubdetail.aspx?pub=9434.

[6] *See* Summary of Comments: In Response to the Commission's Proposed Rules Relating to Security Holder Director Nominations (March 5, 2004).

[7] Chairman Schapiro's speech is available at http://www.sec.gov/news/speech/2009/spch052009mls.htm.

[8] *See* Summary of Comments: In Response to the Commission's Proposed Rules Relating to Security Holder Director Nominations (March 5, 2004).

[9] *Id.*