Legal Updates & News

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Divided SEC Proposes Rules to Permit Shareholder Access to a Company's Proxy Statement for Director Nominations

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On May 20, 2009, a divided Securities and Exchange Commission (the "SEC") proposed changes to the federal proxy rules to permit shareholders to include their director nominations in a company's proxy statement. The proposal was approved by a 3-2 vote along party lines.

The proposal would create a new Rule 14a-11 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and modify Exchange Act Rule 14a-8(i)(8). Under proposed new Rule 14a-11, certain shareholders would have access to a company's proxy statement to nominate director candidates, unless the shareholders are otherwise prohibited from doing so by either state law or the company's

charter or bylaws. Under the proposed amendment to Rule 14a-8(i)(8), qualifying shareholders would be able to submit shareholder proposals seeking to amend, or request an amendment of, provisions of the company's governing documents addressing the company's director nomination procedures.

This legal update is based on information provided at the open meeting and in the SEC's press release announcing the proposal.[1] We will provide a more detailed discussion of the proposal when the text of the rule proposal is available.

Background

Shareholder access is one of the most significant corporate governance issues today, and the current proposals are the SEC's third major attempt to deal with the topic in the past six years. Shareholders have been demanding increased access, while companies vigorously assert that shareholders are adequately protected by existing corporate governance standards. Under the current proxy rules, shareholders do not have the right to include director nominees in a company's proxy statement. Instead, a shareholder seeking to nominate its own directors must engage in a potentially expensive proxy contest using the shareholders' own proxy materials.

The SEC attempted to address this issue in both 2003 and 2007 by proposing rules that would have

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granted shareholders access rights or the right to propose bylaw amendments that would permit shareholders to have director nominees included in the company's proxy statement. The 2003 proposal would have required companies to include up to three director nominees proposed by shareholders in the company's proxy statement upon the occurrence of specified triggering events (e.g., the receipt of greater than a 35% "withhold" vote in a director election, or the approval of a shareholder proposal to require access). The 2007 proposal would have required companies to include shareholder proposals for bylaw amendments regarding director nomination procedures in the company's proxy statement, if the nominating shareholder owned more than 5% of the voting securities of the company, held such securities for more than one year, and was eligible to file a Schedule 13G.

In both 2003 and 2007, after receiving strong criticism of the proposals from, among others, those who perceived the SEC to be encroaching on an area of corporate governance better left to state law, the SEC chose not to adopt the proposals. Instead, the SEC adopted an alternative proposal in 2007 that amended the proxy rules to clarify that Rule 14a-8(i)(8) permits companies to exclude from their proxy statement any shareholder proposals that would result in a contested election in the year of the proposal or in future years.

On April 10, 2009, Delaware addressed the shareholder access debate by enacting new Section 112 of the Delaware General Corporation Law, which will allow Delaware corporations to adopt bylaws requiring the company to include in its proxy materials one or more candidates nominated by shareholders for election to the company's board of directors. Bylaws adopted under new Section 112, which will become effective on August 1, 2009, may include conditions related to such shareholder nominations, including minimum stock ownership, duration of ownership, and a limitation on the number of directors that can be nominated.

On May 19, 2009, a day before the scheduled SEC meeting, the far-reaching "Shareholder Bill of Rights Act of 2009" was introduced in the U.S. Senate, which would establish, among other things, parameters for the SEC to set rules allowing easier shareholder access to company proxy solicitation materials for purposes of nominating directors.[2]

Highlights of the SEC's Proposal

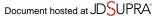
The proposed rules related to shareholder access would be included in a new Rule 14a-11 and the proposed rules related to shareholder proposals would be included in an amendment to Rule 14a-8(i)(8).

Proposed Rule 14a-11 would apply to all Exchange Act reporting companies with a class of equity securities registered under the Exchange Act. The proposal includes both a minimum level of ownership that is required before a shareholder could take advantage of the rule, which would be scaled based on the size of the company, and a duration of ownership requirement. In particular, shareholders would be eligible to have their director nominees included in the company's proxy materials if they own:

- 1% or more of the voting securities of a company that is a "large accelerated filer" (companies with an aggregate worldwide market value of \$700 million or more) or a registered investment company with net assets of \$700 million or more;
- 3% or more of the voting securities of a company that is an "accelerated filer" (companies with an aggregate worldwide market value of \$75 million to \$700 million) or a registered investment company with net assets of \$75 million to \$700 million; or
- 5% or more of the voting securities of a company that is a "non-accelerated filer" (companies with an aggregate worldwide market value of less than \$75 million) or a registered investment company with net assets of less than \$75 million.

Shareholders would be permitted to aggregate their holdings to meet the threshold requirements. In addition, shareholders would be required to have held their securities for at least one year and certify that they will hold their shares through the annual meeting to be eligible to include their nominees in a company's proxy materials.

The proposal contains important limitations on eligibility for access that would require a shareholder to certify, on a new Schedule 14N that would be required to be filed with the SEC, that they are not seeking



to change the control of the company or to obtain more than minority representation on the board of directors. In that regard, the maximum number of director candidates that all shareholders would be allowed to nominate is capped at the greater of 25% of the company's board of directors and one director. In the event more than one qualified shareholder is requesting nominations and the number of shareholder nominees would exceed this cap, the first qualified shareholder satisfying the advance notice requirements would be eligible to nominate its director candidates.

Shareholder nominees must satisfy the independence standards of the applicable national securities exchange or national securities association of the company.

The SEC also proposes to amend Rule 14a-8(i)(8), which governs the exclusion of shareholder proposals related to director elections. The proposed amendment to Rule 14a-8(i)(8) would narrow the current "election exclusion," such that all shareholder proposals by qualified shareholders that would amend, or request an amendment to, provisions of a company's governing documents concerning director nomination procedures or other director nomination disclosure provisions (provided that those disclosure provisions do not conflict with proposed Rule 14a-11) would not be excludable.

Next Steps - SEC Comment Period

The SEC requested that all interested parties provide comments on the proposal. Comments on the proposal will be accepted by the SEC for 60 days following the publication of the proposed rule in the Federal Register. Anyone wishing to comment on the proposal should follow the instructions provided by the SEC at: http://www.sec.gov/rules/submitcomments.htm.

The proposal represents a very significant departure from the current proxy rules. Given the populist anger underlying the current debate that is driving a good deal of the political attention on corporate governance, companies should pay close attention to what will certainly be a heated debate during the comment period. While it is difficult to predict what form the rules may ultimately take (if adopted at all), we believe that the SEC will be working toward putting rule changes in place in anticipation of next year's proxy season.

Footnotes

[1] The SEC's press release, "SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholder to Nominate Directors," dated May 20, 2009, is available at http://www.sec.gov/news/press/2009/2009-116.htm.

[2] For our discussion on the proposed Shareholder Bill of Rights, see "<u>Far-Reaching Shareholder Bill of Rights Introduced in Senate</u>."