

SEC Adopts Proxy Access

August 25, 2010

Please feel free to contact us if we can provide further information on these matters.

John W. White
212.474.1732
jwhite@cravath.com

C. Allen Parker
212.474.1765
aparker@cravath.com

Marc S. Rosenberg
212.474.1676
mrosenberg@cravath.com

Susan Webster
212.474.1660
swebster@cravath.com

Richard Hall
212.474.1293
rhall@cravath.com

Kimberley S. Drexler
212.474.1434
kdrexler@cravath.com

At an Open Meeting earlier today, the Securities and Exchange Commission (the “SEC” or the “Commission”) voted, 3 to 2, to adopt new rules providing a federal right to “proxy access” for shareholders of public companies. Put simply, proxy access will enable certain shareholders of a public company to use the company’s proxy card, at the company’s expense, to nominate candidates chosen by those shareholders for election to the company’s board of directors. Shareholders, or groups of shareholders, who have owned 3% of a company’s voting stock for at least three years will be able to nominate candidates representing up to 25% of the company’s board members. The rules adopted today were originally proposed in June 2009 following failed efforts by the Commission to adopt proxy access rules in 2003 and 2007. Against the backdrop of these various proposals, there had been persistent concerns raised in some quarters that the Commission lacked the authority to adopt such rules. The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act, however, granted the SEC express authority to adopt proxy access.

The SEC has already posted its rulemaking release, which is available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>. The rules will become effective 60 days after their publication in the Federal Register, which we anticipate will occur by Labor Day. Accordingly, the SEC’s new proxy access rules will be in effect for the 2011 proxy season for most companies (depending on their proxy mailing dates last year and certain other factors described below). The following discussion does not analyze all the details of today’s rulemaking but endeavors to provide a high-level summary of the most important features of the new rules.

THE NEW ACCESS REGIME

The SEC has created proxy access through adoption of new Rule 14a-11. Unlike past considerations of proxy access by the Commission, and consistent with the 2009 proposal, the SEC’s new proxy access rules are not subject to any “triggering events” at a given company. In other words, upon effectiveness, proxy access will apply immediately to all public companies in the U.S. that are subject to the Commission’s proxy rules and are not smaller reporting companies (generally companies that have less than \$75 million in non-affiliated public float). The Commission has deferred proxy access for smaller reporting companies for three years. The key aspects of proxy access under new Rule 14a-11 are as follows:

- **Eligibility to nominate candidates.** Proxy access will be available to shareholders, or groups of shareholders, who meet certain ownership tests. Specifically, an eligible shareholder (or group of shareholders) must continuously hold at least 3% of the voting stock of a company for at least three years prior to the time the shareholder (or group of shareholders) notifies the company of its intent to nominate director candidates. Stock lent to others is included in the 3%, so long as the shareholder has the right to recall the stock and will do so if the nominee is included in the proxy; stock sold short is excluded, as is borrowed stock. The ownership criteria were revised from the proposal based on comments the Commission received. As initially proposed, Rule 14a-11 would have been available to shareholders beneficially holding at least 1% of the stock of large accelerated filers, 3% of accelerated filers and 5% of non-accelerated filers, and the holding period requirement would have been only one year. Shareholders will not be able to use the new proxy access rules if they are seeking to change control of the company or to gain more seats on the board than the maximum provided for in Rule 14a-11.
- **Number of nominees.** Shareholder proponents will be able to use Rule 14a-11 to nominate candidates representing up to 25% of a company’s board members or one candidate, whichever is greater. In the case of a company with a classified, or staggered, board, the 25% will apply to the total number of directors on the board, not only those up for election that year. When a company receives more shareholder nominations than it is required to include in its proxy materials, the company will need to include the nominees put forward by the shareholders or group of shareholders representing the largest ownership stakes. Like the ownership thresholds discussed above, this provision is also a change from the proposal, which would have given preference to the nominating shareholder or group that first provided timely notice.
- **Nominee criteria.** Conditions to a person’s eligibility to be nominated to a company’s board by a shareholder pursuant to the new proxy access rules include (i) the nominee’s candidacy, and, if elected, board membership, being consistent with applicable law and regulation, (ii) the nominee satisfying the objective independence standards of the national securities exchange on which the

“[A]s a matter of fairness and accountability, long-term significant shareholders should have a means of nominating candidates to the boards of the companies that they own—candidates that all shareholder-voters may then consider alongside those who are nominated by the incumbent board.”

— SEC Chairman Mary Schapiro, August 25, 2010

company's securities are listed and (iii) the nominating shareholder or group having no agreement with the company regarding the nomination or the nominee prior to the nominator's notice to the company of its intent to put forward a nominee.

- **Disclosure.** Nominating shareholders will need to give to the company notice that provides certain disclosures and file such notice over the Commission's EDGAR system on a new Schedule 14N. The notice must include the size and duration of the nominator's shareholdings and confirm the nominator's intent to continue to hold the subject securities through the date of the meeting. The nominator must also disclose its plan with regard to holding the company's stock after the meeting. Additionally, the disclosure must include certifications as to the nominator's eligibility to submit a nomination and that the nominator does not intend to change control of the company, as well as information about the nominating shareholder or group and the related director nominees similar to that required in proxy contests, all of which will then be included by the company in its proxy materials. Nominees put forward by shareholders pursuant to the new access regime will not be required to meet a company's standards for director qualifications but the nominating shareholders must provide a statement disclosing their analysis as to whether their nominee meets those standards. Nominating shareholders will also be permitted to provide a statement in support of their nominees, not exceeding 500 words, which the company must include in its proxy statement. Nominating shareholders or groups will be liable for any false or misleading statements provided to the company, and companies will not be responsible for those statements when they are included in the company's proxy materials.
- **Timing.** In order to qualify, shareholders must provide notice to the company of their proposed nominations no earlier than 150 days and no later than 120 days prior to the anniversary of the distribution of the prior year's proxy materials. We understand that this timing window will apply even if the company's advance notice by-law period, which otherwise would govern such matters, opens or closes on a different schedule.
- **Relationship to state law and company by-law provisions.** The federal proxy access right is additional to any state law proxy access rights; if the eligibility thresholds set by the federal rules are lower than those set expressly by state law or adopted by a company pursuant to enabling state law provisions, the federal standards will control. The Commission expressly considered numerous comments that it should allow for "private ordering"—that is, allowing companies or their shareholders to choose more restrictive standards for proxy access (including no access at all)—and rejected those arguments. The new federal rules also preempt any state laws that might impose limitations on shareholders' proxy access rights that are contrary to the new federal standard, although the federal rules will not operate at all in cases where either a company's governing documents or the laws of the state in which the company is incorporated prohibit shareholders from nominating board candidates.

At the Open Meeting, Meredith Cross, the Director of the Division of Corporation Finance, spoke about the availability to companies of the Division's no-action process to determine if a company may exclude a shareholder's director nominee and emphasized the Division's commitment to this no-action process and to meeting companies' timing needs. (Rule 14a-11 requires a company to provide notice to the Commission if it intends to exclude a nominee but does not require the company to seek no-action relief for that exclusion.)

COROLLARY AMENDMENT TO RULE 14a-8

The SEC has also amended its Rule 14a-8(i)(8) to allow shareholders eligible to submit proposals under Rule 14a-8—currently, those holding at least \$2,000 in market value of the company's voting securities for at least one year as of the date the proposal is submitted—to submit their own by-law proposals on proxy access for inclusion in a company's proxy materials. These proposals could provide for different access rights, including more liberal ones, than those under the federal proxy access rules, but cannot replace the Commission's access regime, which will remain available to shareholders in any case.

CONCLUDING THOUGHTS

Companies should consider taking measured and appropriate steps at this point to reduce the likelihood that they may be targets for shareholder ire, which in turn may reduce the extent to which those companies will find themselves the subject of shareholder-initiated proxy contests now that proxy access has been adopted by the SEC. Such steps might include reviewing corporate governance, management and executive compensation issues to determine whether there are any problematic areas that should be addressed and, where appropriate, outreach to shareholders. Nominees proposed pursuant to the new access rules will need to appear on the company's proxy card in addition to the slate of director nominees put forth by the company and will result in a contested election. For many companies with a majority vote standard for director elections, contested elections are subject to the traditional plurality standard, but companies may want to review their election rules now to ensure that they will operate as desired within the SEC's proxy access framework. Companies as well as other advisors to boards of directors may also want to review with their current directors these mechanics and their possible implications so that they know what to expect during the upcoming proxy season.

This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.

New York
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
212.474.1000

London
CityPoint
One Ropemaker Street
London EC2Y 9HR
44.20.7453.1000