

Alert

SEC Votes 3-2 to Seek Public Comment on Proxy Access Proposal

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On May 20, 2009, the SEC voted 3-2 to solicit public comment on proposed rules that will, for the first time, allow shareholders to nominate directors for election by way of the company proxy materials. Generally, proposed Rule 14a-11 would allow shareholders who own 1%, 3% or 5% of a public company's stock, depending on its market capitalization, to nominate up to 25% of the board seats up for election each year, subject to numerous conditions. In addition, Rule 14a-8(i)(8) would be amended to allow shareholder proposals regarding the director-nomination process. SEC Chairman Schapiro was joined by Commissioners Walter and Aguilar in approving publication of the proposed rules. Commissioners Casey and Paredes dissented, citing concerns over statutory authority and conflicts with state law. The proposed rules will be published in the next two weeks and public comments are due within 60 days thereafter.

Rule 14a-11 Proxy Access Overview

Eligibility based on share ownership and no control intent

Proposed Rule 14a-11 would allow shareholders to nominate directors based on share-ownership levels, market capitalization of the company and no control intent. Specifically, the proposal would require a single shareholder or group of shareholders to own at least 1% of the voting securities of a \$700 million or greater market capitalization company to be eligible to nominate a director, as long as they certify that they have no intention of seeking to change control of the company or to gain more than minority representation on the board. The proposed rule increases the share-ownership requirements for proxy access as a company's market capitalization decreases. To be eligible to nominate a director, it requires a shareholder or group of shareholders to own at least 3% of a company whose market capitalization is between \$700 million and \$75 million. Shareholders in public companies below \$75 million in market capitalization must own at least 5% of the voting securities to be eligible to nominate directors via the company proxy materials. This sliding scale represents a reduction from the SEC's 2003 and 2007 proposals, which required 5% ownership regardless of a company's market capitalization. The change addresses complaints that a 5% threshold would be too onerous for companies with very large market capitalizations.

One-year stock ownership holding period required

The proposed rule would require a shareholder or group of shareholders to own the requisite percentage of stock for one year prior to the nomination notice deadline, and to hold the shares through the election date. This holding period is a reduction from the 2003 SEC proposal, which required a two-year hold prior to notice deadline and through the election date.

Number of director nominees: 25% or one director, whichever is greater

Shareholders who meet the foregoing eligibility requirements will be able to nominate at least one director and up to 25% of the board. There was no discussion regarding a staggered board scenario and it would appear that the 25% maximum applies to the full number of board seats rather than the number of seats up for

election in a particular year (as was the case in the 2003 and 2007 proposals). The limitation on the number of director nominees is consistent with the no-control-intent requirement of the rule.

Director nominees must be independent of the shareholder

The proposed rule requires that the director nominee be independent of the shareholder or shareholder group that makes the nomination. Independence is defined by reference to either the NYSE or Nasdaq independent director definition. This provision appears consistent with the SEC's 2007 proposal. Also, no direct or indirect agreement is permitted between the company and the nominating shareholder regarding the nomination of the nominee.

Multiple shareholder nominations: First in time, first in right

The SEC staff announced that whenever more than one shareholder or group submits competing nominations, the first shareholder notice received by the company will control. This "first in time, first in right" approach addresses a contentious issue of whether there should be a limit on the number of nominees placed on the proxy card where multiple shareholder nominations are submitted. This "race to the mailbox," as characterized by the SEC staff, is different than the 2003 SEC proposal, which favored the nominees of the shareholder representing the largest number of shares.

Schedule 13G eligibility is not jeopardized by a Rule 14a-11 director nomination or election

During the SEC meeting, the staff provided the following guidance regarding Rule 14a-11 and Schedule 13G:

[A] beneficial owner who acquires or holds a company's securities in connection with a nomination under the procedure would not lose Schedule 13G eligibility 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 rules.

In addition, the proposed rule includes two new proxy exemptions for shareholders seeking to form a nominating shareholder group and solicitations by those shareholders in support of the shareholder nominee for director. In the aggregate, these measures should provide some relief to shareholders who wish to nominate a director via Rule 14a-11.

New Schedule 14N requires disclosure consistent with proxy contest standard

Shareholders who nominate directors pursuant to proposed Rule 14a-11 will be required to file Schedule 14N with the SEC and to provide a copy to the company. The SEC staff has described the schedule's disclosure requirements as comparable to the information required of proxy contestants, but for a statement certifying no control intent. The proposed disclosure requirements represent a relaxation of the 2007 standard proposed by the SEC. This development was not unexpected after Commissioner Walter's criticism of the 2007 disclosure standard in a February 2009 speech.

Rule 14a-8(i)(8) Amendments to Allow Proposals Regarding Nomination Process

Currently, Rule 14a-8(i)(8) prohibits any shareholder proposal that relates to elections by the company. In light of the Rule 14a-11 proposal, the SEC is proposing amendments to Rule 14a-8(i)(8) that would allow shareholders to submit proposals to amend the issuer's governing documents with respect to the procedure for nominating and electing directors. However, a shareholder proposal under amended Rule 14a-8(i)(8) cannot modify the requirements of Rule 14a-11.

Summary

The SEC decision to publish the proxy-access proposal for public comment is a positive sign that, come 2010, shareholders may be able to nominate directors on the company proxy card. While it should not be forgotten that the SEC tried to adopt proxy access in both 2003 and 2007, a change in administrations and SEC commissioners may result in a different outcome for proxy access in 2009. However, even if the SEC adopts proxy access, litigation is expected. On the other hand, federal legislation regarding proxy access is possible, as evidenced by the recent Shareholder Bill of Rights Act of 2009, sponsored by Senators Schumer and Cantwell. Whatever the eventual outcome, the current proposal is an improvement over prior versions primarily because both the share ownership threshold and holding period were reduced to more reasonable levels.

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