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## SEC Publishes Proposed Rules on Proxy Access

The Securities and Exchange Commission recently published proposed amendments to the federal proxy rules to implement “proxy access” — a set of rules that would allow stockholders of public companies to nominate candidates for election as a director and have those nominees included in the company’s proxy materials (proxy statement and proxy card). If adopted in its present form, proxy access would encourage stockholders to nominate candidates for director to stand for election in opposition to the board’s own nominees. The proposed rules would add significant uncertainty to the director election process, create the opportunity for the election process to be used by investors to pursue private agendas and, ultimately, could have a profound impact on public company boards.

### A Basic Flaw

Many issues can and no doubt will be raised about the SEC’s proposed proxy access rules. However, assuming that federal proxy access rules will be adopted, one of the most troubling aspects of the SEC’s proposal is that it effectively preempts companies from establishing reasonable criteria for nominators and nominees who wish to use the proxy access process. Under recently enacted Delaware legislation (Section 112 of the Delaware General Corporation Law), companies are expressly authorized to adopt proxy access bylaws containing reasonable criteria for nominators and nominees. The SEC’s proposal appears to bar all criteria more restrictive than those provided by and referenced in the proposal. Many differences exist among public companies that justify individually established proxy access criteria, provided they are reasonable. Moreover, the SEC’s proposed minimal criteria can easily set too low a bar for proxy access in many companies. Rather than using a “one size fits all” approach (putting aside the tiered ownership thresholds, where distinctions among companies are recognized), hopefully the SEC will be convinced that state law (perhaps with the SEC monitoring its efficacy) and the multiplicity of reasonable outcomes it would permit, is a more sensible approach for the time being for regulating the appropriate criteria for proxy access.

### Actions to Take Now

**Comment on the Proposed Rules** – The SEC requested comments on hundreds of questions. The topics range from the appropriate stock ownership thresholds required for a stockholder to be eligible to make access nominations to whether proxy access should apply when a third party is soliciting proxies for its own slate of board nominees in a traditional proxy contest. If proxy access is coming — and the SEC appears intent on having final rules in place for the 2010 proxy season — the public comment process may be critical in shaping the final rules. Companies should consider providing comments, either individually or as part of business or trade associations or bar association groups. Comments are due by August 17, 2009.

**Consider Amending Advance Notice Bylaws** – The proposed deadline for submitting access nominees is the deadline established by a company’s advance notice bylaw (or, in the absence of such a bylaw, 120 days before the first anniversary of the date on which the company mailed its proxy statement for the previous year’s annual meeting). As described in greater detail below, the SEC is proposing a process — similar to the existing process under Rule 14a-8 for companies to submit no-action requests to the SEC staff to exclude stockholder proposals — in which companies could seek SEC staff concurrence with a company’s determination that, as a result of the nominating stockholder’s failure to comply with the SEC rules, the access nominees can be excluded from company proxy materials. Under the proposed rules, the timetable for this process requires nearly 120 days prior to the filing of the company’s definitive proxy materials with the SEC (or approximately 150-160 days prior to the date of the stockholder’s meeting). Most advance notice bylaws, however, set a nominations deadline that is much shorter and would not afford companies sufficient time to avail themselves of the new no-action process. Also, there may not be sufficient time for companies to amend their advance notice bylaws after final proxy access rules are adopted. As a result, companies should review their advance notice bylaws now and consider whether any modifications are appropriate.

**Take a Fresh Look at Investor Relations Programs** – There are a number of economic and political factors driving the current surge of corporate governance reforms. One factor may be a sense among institutional investors that their concerns often are ignored by many companies in which they invest. If proxy access is inevitable, companies may want to take a fresh look at their investor relations programs with a view to improving their relationships with institutional investors and building institutional investors’ confidence in the company’s board (and management) so that proxy access remains a tool “sitting on the shelf” rather than one that is used.

## The Proxy Access Proposal

**Eligible Stockholders.** Proxy access, under proposed Rule 14a-11, would apply to all companies (including investment companies) with a class of equity securities subject to the SEC’s proxy rules. A stockholder or group of stockholders would be eligible to have its nominees included in the company’s proxy materials if the stockholder or group beneficially owned for at least one year prior to making the nomination the applicable percentage of voting securities set forth below:

- 1% of the company’s voting securities for “large accelerated filers” (generally companies with a public float of \$700 million or more) or registered investment companies with net assets of \$700 million or more;
- 3% of the company’s voting securities for “accelerated filers” (generally companies with a public float of \$75 million or more but less than \$700 million) or registered investment companies with net assets of \$75 million or more but less than \$700 million; or
- 5% of the company’s voting securities for “non-accelerated filers” (generally companies with a public float below \$75 million) or registered investment companies with net assets of less than \$75 million.

The nominating stockholder or group would be required to represent its intent to hold its shares through the date of the annual meeting, as well as disclose its intent with respect to continued ownership of the shares after the election. In addition, the nominating stockholder or group would be required to certify it is not holding the stock or making the nominations to effect a change of control of the company.

*Number of Access Nominees; Independence.* The stockholder or group would be able to nominate candidates for up to 25% of the company's board of directors (rounded down to the closest whole number, but not less than one). In the case of a staggered board, any access nominees previously elected and continuing to serve on the board beyond the upcoming election of directors would count against the 25% cap. Companies that receive nominations under proxy access from multiple stockholders or groups would include in the company proxy materials the person(s) nominated in the first nomination notice received. In the event that the first nominating stockholder or group does not nominate the maximum number of access candidates permitted, the company would look to subsequent timely nominations in the order of receipt until reaching the 25% limit. As proposed, there is no provision addressing the earliest date on which access nominations may be made.

Proxy access nominees must satisfy the objective director independence standards under the stock exchange rules applicable to the company (but, for purposes of proxy access only, need not satisfy any subjective independence requirements under stock exchange rules or any additional independence or other criteria adopted by the company).

*New Schedule 14N; Other Items.* The nominating stockholder or group would submit nominations to the company on, and concurrently file with the SEC, a new Schedule 14N. The Schedule 14N would contain disclosures about the nominating stockholder or group and the nominee(s) comparable to the disclosure required in an opposition proxy statement relating to a contested election. If the nominating stockholder or group is a beneficial owner of the company shares, as opposed to a record owner, the Schedule 14N must include a written statement from the record owner verifying the nominating stockholder's beneficial ownership of the shares for the requisite period of time. The Schedule 14N also may include a statement in support of the access nominees of up to 500 words that the company would be required to include in its proxy statement. An amendment to the Schedule 14N would be required in the event of material changes in the information included therein. The nominating stockholder(s) would be liable for any false or misleading statements in the Schedule 14N repeated in the company's proxy statement (with potential company liability if the company knows or has reason to know that the information is false).

Inclusion of access nominees in a company's proxy statement would not, by itself, require the company to file its proxy materials in preliminary form.

In addition, limited exemptions to certain proxy rules would permit a stockholder to solicit others in order to form a nominating group and to solicit in support of access nominees. The exemptions require, among other things, that written communications be filed with the SEC on the date of first use.

### **Process to Exclude an Access Nominee**

An access nominee may be excluded from the company's proxy materials if:

- The nominating stockholder or group does not satisfy the proxy access stock ownership requirements;
- The nominee does not satisfy the objective independence criteria of the applicable stock exchange;
- The Schedule 14N is defective or untimely or any representation required to be included in the Schedule 14N is false or misleading in any material respect; or

- The company has received more access nominations than it is required to include in its proxy materials.

If a company determines that none of the bases for exclusion exist, the company must notify the stockholder or group not later than 30 days before the company files its definitive proxy materials with the SEC that the company will include the nominee(s) in the company's proxy materials.

If the company determines that it has a basis to exclude an access nominee, the following process applies:

- Within 14 days after the company's receipt of the Schedule 14N, the company must notify the nominating stockholder or group of the company's determination in writing, including an explanation of the company's basis for excluding the nominee(s).
- Within 14 days after receipt of the company's notice, the nominating stockholder or group would have to respond to that notice and correct any eligibility or procedural deficiencies identified in that notice. Neither the composition of the nominating group nor the nominee(s) can be changed to cure any deficiency, other than reducing the number of nominees to comply with the 25% limit.
- No later than 80 days before the company files its definitive proxy materials with the SEC (and after providing the notice described above and the passage of sufficient time for the nominating stockholder to provide its response), the company must notify the SEC and the nominating stockholder or group of its intent to exclude the nominating stockholder's or group's nominee(s) and the basis for its determination.
- Within 14 days of the nominating stockholder's or group's receipt of the company's notice to the SEC, the nominating stockholder or group may submit to the company and the SEC a response to the company's notice.
- As soon as practicable, the SEC staff would, at its discretion, provide a no-action letter containing its views to the company and the nominating stockholder or group.
- No later than 30 days before the company files its definitive proxy materials, the company must provide the nominating stockholder or group with notice of whether it will include or exclude the nominee(s).

### **Proposed Amendments to Rule 14a-8**

The SEC's current rules on stockholder proposals permit the exclusion of proposals relating to director elections — the so-called "election exclusion." In 2007, the SEC amended the election exclusion to clarify that companies could omit proxy access stockholder proposals.

The SEC is proposing an amendment to narrow the election exclusion to permit stockholder proposals, whether binding or precatory, proposing amendments to a company's governing documents regarding the company's nomination procedures or other director nomination disclosure provisions, so long as the proposed amendment does not conflict with the SEC's proxy access rules (or other applicable law). In effect, the SEC's proxy access rules will create a floor and stockholders would be free to propose and adopt more expansive versions of proxy access.