

August 10, 2007

The SEC's Shareholder Nomination Proposals

The SEC has published its controversial proposals that include two opposing approaches to address the ability of shareholders to include director nominees in a company's proxy materials. These proposals are the culmination of an ongoing debate over what constitutes an appropriate shareholder nomination process. The debate jumped into the spotlight with the SEC's 2003 "shareholder access" or "proxy access" proposal which would have required companies to include in their proxy statements director nominees submitted by a 5% or greater shareholder the year after the receipt of a 35% or more withhold vote by one or more of the company's director candidates or the approval of a shareholder proposal that would subject the company to the shareholder nomination process. Facing intense opposition from all sides (business interests thought the proposal went too far in giving shareholders access to company proxy materials, while shareholder interests thought the proposal did not go far enough), the 2003 proposal stalled. Adding to the confusion was the Second Circuit's decision in *AFSCME v. AIG*, which, contrary to the SEC's own interpretation of Rule 14a-8(i)(8) of the proxy rules, held generally that proxy access proposals could not be excluded from company proxy materials.

Against this backdrop, the SEC took the unusual step of proposing two alternative sets of rule amendments. One proposal would, in general terms, (i) require companies to include in their proxy materials proposals for binding bylaw amendments that establish a procedure by which shareholder nominees would be included in company proxy materials, if the proposal is submitted by a more-than-5% shareholder (or shareholder group) that qualifies to file, and has filed, a Schedule 13G as an institutional or passive investor and (ii) promote shareholder communication by eliminating certain federal securities law ambiguities surrounding the formation of online shareholder discussion forums, in each case subject to certain conditions (the "New Shareholder Access Proposal"). The other proposal would codify the interpretation of Rule 14a-8(i)(8) that companies may exclude from their proxy materials any shareholder proposal that would result in an immediate election contest or set up a process for shareholders to conduct a future election contest by requiring the inclusion of a shareholder nominee in subsequent proxy materials (the "Election Contest Proposal").

The members of the Commission were split on the proposals. Chairman Cox acted as the swing vote in favor of both proposals for now and hopes that the ensuing public debate will result in the adoption of a final, unambiguous rule in time for next year's proxy season.

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The New Shareholder Access Proposal

Shareholder Proposals

Under the New Shareholder Access Proposal, a shareholder or group of shareholders owning more than 5% of a company's shares entitled to vote on the matter at an annual meeting could submit, and the company would be required to include in its proxy materials, a proposal to amend the company's bylaws to establish a procedure by which shareholder director nominees would be included in the company's proxy materials, if:

- The bylaw will be binding on the company once approved by the shareholders;
- The shareholder or shareholder group has continuously held more than 5% of the company's shares entitled to vote for at least one year by the date the proposal is submitted; and
- The shareholder or shareholder group is eligible to file, and has filed, a Schedule 13G as an institutional or passive investor.

We note that the one-year ownership and Schedule 13G eligibility requirements would effectively limit the use of this proposed process to longer term shareholders (such as institutional holders or pension funds) who, while seeking a greater voice on the board, have acquired shares in the ordinary course of their business and not with the purpose or effect of changing or influencing the control of the company. Further, Schedule 13G eligibility is a facts and circumstances analysis. The SEC itself asks, in its request for comment, whether there is any tension between the Schedule 13G requirement that the securities not be acquired or held for the purpose of changing or influencing control of the company and the desire of the holder of such shares to propose a bylaw amendment regarding the submission of director nominees. Thus, exactly how the Schedule 13G eligibility condition will work in practice remains a question.

Persons seeking to control the company would, of course, continue to be able to wage a traditional proxy contest under existing proxy rules using their own proxy statement.

The bylaw proposal may be written as the proposing shareholder deems appropriate, so long as it conforms with applicable state law and the company's governing documents. For example, the proposing release lists as possible bylaw amendments those specifying a minimum level of share ownership for those making director nominations, the number of director slots subject to the bylaw procedure or a method for the allocation of any costs related to the procedure.

Once a shareholder or shareholder group forms a "plan or proposal" to submit a bylaw proposal (which includes both actual submission of a proposal and an indication of an intent to management to submit such a proposal or to refrain from submitting such a proposal conditioned on the taking or not taking of a corporate action), the shareholder proponents would be required to file or update their Schedule 13G with new Item 8A-8C disclosures about their relationships with the company and other relevant background information about themselves. The company would also be required to include certain of these disclosures in its proxy statement pursuant to new Item 24 of Schedule 14A and may rely on the shareholder proponents' Schedule 13G to comply with this requirement. See Exhibit A for more detail on these disclosure requirements.

If the bylaw amendment is approved by the requisite vote of shareholders under state law and the company's governing documents, shareholders later proposing director nominees for inclusion in a company's proxy materials pursuant to such bylaw would again be subject to new disclosure requirements. Upon the formation of a plan or proposal to submit a nominee (which also includes indications of interest to management as discussed above with respect to bylaw proposals), nominating shareholders would be required to provide the Schedule 13G Item 8A-C disclosures to the company. Then, when the nominating shareholders submit their director nominees for inclusion in the company's proxy materials, the nominating shareholders would also have to provide the disclosure currently required for shareholders soliciting proxies in opposition to the company with respect to the election or removal of directors under existing Items 4(b), 5(b), 7 and 22(b) of Schedule 14A and a statement that shareholder nominees consent to being named in the proxy materials and will serve if elected. If the nominating shareholders fail to provide any of the foregoing information, the company would not have to include the shareholders' nominees in its proxy materials.

Under the proposed rules, the company would also be required to make the following additional disclosures if it includes shareholder nominations in its proxy materials:

- Immediately after receipt of the new Schedule 13G Item 8A-C information from the nominating shareholders, the company must provide the information on its website or provide a link to a website address where such information will appear. The company must also include this information in the related proxy statement under new Item 25(a) or on a website to which the proxy statement refers.
- When the shareholder submits its director nominees to the company for inclusion in the company's proxy materials, the company must include the Schedule 14A Item 4(b), 5(b), 7 and 22(b) disclosure in its proxy statement under new Item 25(a) or on a website to which the proxy statement refers.
- The company would additionally be required to include certain of the same Schedule 13G Item 8A-C disclosures in its Schedule 14A pursuant to new Item 25(b). (See Exhibit A)

If a shareholder nominee is included in the company's proxy materials, the company would have to file its proxy statement in preliminary form and be subject to SEC review in the same manner as under the existing rules for proxy contests.

The proposed rules explicitly state that companies would not be liable for information provided by nominating shareholders and that no such information would be deemed incorporated by reference into any other SEC filing unless the company specifically incorporates that information by reference.

Online Shareholder Forums

In an effort to harness the shareholder communications potential of the Internet, the New Shareholder Access Proposal also seeks to facilitate shareholder communication by eliminating certain federal securities law ambiguities surrounding the formation of online shareholder forums. Such activities are not currently prohibited, but the proposed rules are intended to clarify various

issues not addressed by the existing proxy rules, particularly liability and other issues, such as whether participation in such a forum constitutes a solicitation of proxy.

The proposed rules would specify that companies and shareholders may establish, maintain or operate a shareholder forum to facilitate interaction among shareholders and between the company and its shareholders as they deem appropriate, so long as the forum complies with the federal securities and other applicable federal and state law and the company's charter and bylaws.

The proposed rules would exempt from federal proxy rules any solicitation made in a shareholder forum established pursuant to the SEC rules by or on behalf of any person who is not seeking directly or indirectly any proxies and does not furnish or otherwise request any form of revocation, abstention, consent or authorization so long as the solicitation is made more than 60 days before the next shareholder meeting or, if the company announces the date of the next shareholder meeting less than 60 days before the meeting date, not more than two days after such announcement. A participant in a shareholder forum would be eligible to solicit proxies within the 60 days before a shareholder meeting if they do so in accordance with existing proxy rules.

Under the proposed rules, no company or shareholder would be liable solely as a result of their establishing such a forum under the federal securities laws for any statement or information provided by another forum participant. Forum participants would be liable for the content of their own statements under existing theories of liability, such as Section 17(a) of the Securities Act and Sections 10(b) and 20(e) of the Exchange Act.

The Election Contest Proposal

At the same time as it proposed the New Shareholder Access Proposal, the SEC also proposed an alternative amendment to Rule 14a-8(i)(8) that would instead codify the view that shareholder proposals that would result in an immediate election contest (*e.g.*, by making or opposing a director nomination for a particular meeting) or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings, would be excludable from company proxy statements.

In the proposing release, the SEC was careful to provide guidance to prevent an "inappropriately broad" reading of whether a proposal relates to a director election, including by giving the following examples of proposals that are or are not excludable:

- Excludable proposals include proposals that could have the effect of:
 - disqualifying board nominees who are standing for election;
 - removing a director from office before his or her term expired;
 - questioning the competence or business judgment of one or more directors; or
 - requiring companies to include shareholder director nominees in the company's proxy materials or otherwise resulting in a solicitation on behalf of shareholder nominees in opposition to board-supported nominees.

- Non-excludable proposals include those proposals that relate to:
 - qualifications of directors or board structure (as long as the proposal will not remove current directors or disqualify current nominees);
 - voting procedures (such as majority or cumulative voting);
 - nominating procedures; or
 - reimbursement of shareholder expenses in contested elections.

According to the proposing release, the SEC has long taken the view that shareholders wishing to nominate directors for election to the board of a company should do so under the existing rules regarding solicitations of proxies in opposition to the company's director nominees. These rules call for more detailed disclosure regarding the nominees and the persons making the solicitation and subject the proponent to the anti-fraud provisions of the proxy rules. This is not to say that shareholders cannot make nominations or solicit proxies to vote in favor of their own nominees. Rather, the proposal would clarify that proxies to vote for these nominees must be solicited separately by the proponent and in compliance with existing rules regarding solicitations in opposition.

The Comment Process

As the controversial nature of these proposals warrants, the SEC is seeking comment on many aspects of these proposals. The questions posed by the SEC are too numerous to address in this memo, but we note two interesting points with respect to the New Shareholder Access Proposal:

- As has been reported in the press and noted in particular by Commissioner Campos at the SEC open meeting approving this proposal, there is concern about whether the 5% ownership threshold is appropriate for all companies, even large accelerated filers, where such a high threshold would effectively block any shareholder or shareholder group from using this new bylaw proposal process. The SEC has asked whether a lower threshold or a staggered threshold depending on company size would be more appropriate.
- The SEC has also asked whether there should be further clarification as to the intersection of Schedule 13G and this proposal, *e.g.* would acquiring shares for the express purpose of meeting the ownership threshold under this proposal ruin Schedule 13G eligibility?

In addition, the SEC is seeking comment on whether it should propose separate rules to allow companies or their shareholders to propose and adopt bylaws that would establish the procedures that the company would follow for including *non-binding* proposals in the company's proxy materials.

Comments on both rule proposals and on the SEC's question regarding the treatment of non-binding shareholder proposals are due October 2, 2007. For a copy of the New Shareholder Access Proposal, see <http://sec.gov/rules/proposed/2007/34-56160.pdf>. For a copy of the Election Contest Proposal, see <http://sec.gov/rules/proposed/2007/34-56161.pdf>

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum may be directed to any of the following:

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PROPOSED NEW DISCLOSURE REQUIREMENTS

	PROPONENT DISCLOSURE	COMPANY DISCLOSURE ¹	
	Schedule 13G	Schedule 14A (for bylaw proposals)	Schedule 14A (for director nominees)
PROPOSED DISCLOSURE²			
A description of any direct or indirect interest of the shareholder proponent in any contract between the shareholder proponent ³ and the company or any affiliate of the company (including any employment agreement, collective bargaining agreement or consulting agreement)	Item 8B(a)	Item 24(a)	Item 25(a) ⁴ and (b)
A description of any pending or threatened litigation in which the shareholder proponent is a party or a material participant, involving the company, any of its officers or directors or any affiliate of the company	Item 8B(a)	Item 24(b)	Item 25(a) and (b)
A description of any other material relationship (including any current or past employment relationship or consulting arrangement) between the shareholder proponent and the company or any affiliate of the company not otherwise disclosed	Item 8B(a)	Item 24(c)	Item 25(a) and (b)
A description of any material transaction of the shareholder proponent with the company or any affiliate of the company during the 12 months before the formation of any plans or proposals or the pendency of any proposal or nomination	Item 8B(b)	Item 24(d)	Item 25(a) and (c)

¹ The company is entitled to rely on the shareholder proponent's Schedule 13G disclosures and information provided to the company pursuant to proposed Rule 14a-17(c) to comply with the Item 24 and 25 disclosure requirements.

² The exact text of these disclosure requirements differs slightly between the Schedule 13G and 14A. For the exact text, please refer to the New Shareholder Access Proposal.

³ A "shareholder proponent" is broadly defined as any shareholder or shareholder group that has formed any plans or proposals regarding a bylaw amendment or the submission of a director nominee pursuant to a bylaw amendment, any affiliate, executive officer or agent acting on behalf of the shareholder or shareholder group with respect to the plans or proposals and anyone acting in concert with, or who has agreed to act in concert with, the shareholder or shareholder group with respect to the plans or proposals.

⁴ Proposed Item 25(a) requires disclosure of the information provided by the nominating shareholders to the company as required by proposed Rule 14a-17(b), which in turn requires the company to provide the Schedule 13G Item 8A-C information provided to it by nominating shareholders on its website or to provide a link to a website where the information would appear, in each case immediately after receiving the information from the nominating shareholder.

	PROPONENT DISCLOSURE	COMPANY DISCLOSURE¹	
PROPOSED DISCLOSURE²	Schedule 13G	Schedule 14A (for bylaw proposals)	Schedule 14A (for director nominees)
A description of any discussion regarding the proposal or nomination between the shareholder proponent and a proxy advisory firm during the 12 months before the formation of any plans or proposals or the pendency of any proposal or nomination	Item 8B(b)	N/A	Item 25(a)
If the shareholder proponent holds more than 5% of a competitor (<i>i.e.</i> , any enterprise with the same Standard Industrial Classification code as the company), a description of the number and percentage of securities held in the competitor, as of the date the shareholder proponent first formed any plans or proposals	Item 8B(c)	N/A	Item 25(a)
A description of any material relationship of the shareholder proponent with any competitor other than as a shareholder, as of the date the shareholder proponent first formed any plans or proposals	Item 8B(d)	N/A	Item 25(a)
<p>Disclosure of any meetings or contacts, including direct or indirect communication, by the shareholder proponent with the management or directors of the company that occurred during the 12 months before the formation of any plans or proposals or the pendency of any proposal or nomination, including:</p> <ul style="list-style-type: none"> • Reasonable detail of the content of such direct or indirect communication; • A description of the action(s) sought to be taken or not taken; • The date of the communication; • The person(s) to whom the communication was made; • Whether that communication included any reference to the possibility of such a proposal or nomination; and • Any response by the company or its representatives to that communication prior to the date of filing the required disclosure <p>If a shareholder proponent conducts regularly scheduled meetings or contacts with management or directors of a company, a description of the frequency of the meetings and the subjects covered at the meetings rather than</p>	Item 8B(e)	Item 24(d)	Item 25(a) and (c)

	PROPONENT DISCLOSURE	COMPANY DISCLOSURE¹	
PROPOSED DISCLOSURE²	Schedule 13G	Schedule 14A (for bylaw proposals)	Schedule 14A (for director nominees)
providing information separately for each meeting is sufficient, except that if an event or discussion occurred at a specific meeting that is material to the shareholder proponent's decision to submit a proposal or nomination, that meeting should be discussed in detail separately			
<p>If the shareholder proponent is not a natural person, provision of:</p> <ul style="list-style-type: none"> • The identity of the natural person(s) associated with the entity responsible for the formation of any plans or proposals; • The manner in which such person(s) were selected, including a discussion of whether or not the equity holders or other beneficiaries of the shareholder proponent entity played any role in the selection of such person(s) or otherwise played any role in connection with any plans or proposals; • Whether the person(s) associated with the entity responsible for the formation of any plans or proposals have, in forming such plans or proposals, a fiduciary duty to the equity holders or other beneficiaries of the entity; • The qualifications and background of such person(s) relevant to the plans or proposals; and • Any interests or relationships of such person(s), and of that entity, that are not shared generally by other shareholders of the company and that could have influenced the decision by such person(s) and the entity to submit a proposal or nomination (such as contractual arrangements, current or past employment with the company, employment agreements, consulting agreements and supplier or customer relationships) 	Item 8C(a)	N/A	Item 25(a)

	PROPONENT DISCLOSURE	COMPANY DISCLOSURE¹	
PROPOSED DISCLOSURE²	Schedule 13G	Schedule 14A (for bylaw proposals)	Schedule 14A (for director nominees)
<p>If the shareholder proponent is a natural person, disclosure of:</p> <ul style="list-style-type: none"> • The qualifications and background of such person(s) relevant to the plans or proposals; and • Any interests or relationships of such person(s) that are not shared generally by other shareholders of the company and that could have influenced the decision by such person(s) to submit a proposal or nomination (such as contractual arrangements, current or past employment with the company, employment agreements, consulting agreements and supplier or customer relationships) 	Item 8C(b)	N/A	Item 25(a)
Existing Schedule 14A Item 4(b), 5(b), 7 and 22(b) disclosure and the shareholder nominee(s) consent	N/A (although nominating shareholders are required to provide such information to the company pursuant to proposed Rule 14a-17(c))	N/A	Item 25(a) ⁵

⁵ Proposed Item 25(a) requires disclosure of the information provided by the nominating shareholders to the company as required by proposed Rule 14a-17(b), which in turn requires the company to provide the Schedule 14A Item 4(b), 5(b), 7 and 22(b) disclosure on its website or to provide a link to a website where the information would appear, in each case when the shareholder proponents submit their director nominees.