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The SEC's New Proxy Access Proposals

For no less than the third time in six years, the Securities and Exchange Commission has approved the issuance of a proposal to give shareholders the ability to nominate directors via company proxy materials. Prior proposals stalled after meeting heavy resistance from the business community and shareholder groups alike, for being both too permissive and too restrictive in granting proxy access to shareholders. In this most recent iteration, the two key components of the proposal would (i) create a new Rule 14a-11 that would affirmatively allow shareholder nominations in company proxy materials subject to certain conditions and (ii) narrow Rule 14a-8(i)(8)'s election exclusion to allow shareholder proposals relating to a shareholder nomination process or related disclosure.

Proposed Rule 14a-11 would allow a shareholder or group of shareholders to nominate directors via company proxy materials if they own:

- For large accelerated filers, at least 1% of the shares entitled to vote on the election of directors;
- For accelerated filers, at least 3% of such shares; and
- For non-accelerated filers, at least 5% of such shares.

Shareholder proponents must have owned the requisite securities for at least one year before their notice of nomination is provided to the company and must represent their intent to hold such securities through the meeting date. Importantly, shareholders using proposed Rule 14a-11 must certify that they are not seeking control of the company or more than minority representation on the board. The proposal also includes an exemption from the SEC's proxy solicitation rules for solicitations by shareholders seeking to form a shareholder nomination group or to support a shareholder nominee and clarifies that a beneficial owner who acquires or holds shares in connection with Rule 14a-11 procedures 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 such rule.

Nominating shareholders would be required to provide advance notice of their intent to make such nominations to the company, including representations about their eligibility to make such director nominations and other disclosures similar to that currently required for proxy contests under the U.S. proxy rules and to file such information with the SEC on new Schedule 14N on the date it is provided to the company. This information would ultimately be included in the company's proxy materials with the nominating shareholders having liability for such information. The proposed rule would defer to companies' advance notice provisions

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NEW YORK

1285 Avenue of the Americas
New York, NY 10019-6064
+1 212 373 3000

WASHINGTON, D.C.

2001 K Street NW
Washington, DC 20006-1047
+1 202 223 7300

LONDON

Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44 20 7367 1600

TOKYO

Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81 3 3597 8101

BEIJING

Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86 10 5828 6300

HONG KONG

12th FL, Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852 2536 9933

applicable to shareholder nominations as to the required timing for such notice, but if the company does not have such an advance notice provision, nominating shareholders would be required to notify the company of their intent to nominate directors 120 days before the date of distribution of the proxy materials for the prior year's annual meeting. The proposed rule would establish a procedure pursuant to which companies could seek from the SEC staff exclusion of the shareholder nominees or other remedies in certain circumstances, for example, if there are materially misleading statements in the nominating shareholders' disclosure.

If these conditions are met, shareholders would be able to include in the company's proxy materials nominations of no more than one director or 25% of a company's board, whichever is greater. Shareholder nominations would be taken on a "first-come, first-served" basis according to when a shareholder provides the notice of nomination to the company. Shareholder nominees must meet certain qualifications, including that their nomination and board membership, if elected, would be consistent with applicable state law, that they are considered independent as defined by applicable stock exchange rules and that there be no direct or indirect agreement between the nominating shareholders and the company regarding their nomination.

Ever mindful of the potential for conflict between SEC rules and state law, proposed Rule 14a-11 would only apply to companies incorporated in jurisdictions where shareholders have the right to nominate directors or where such nominations are not otherwise prohibited by the companies' governing documents.

As a corollary to the direct access process discussed above, the proposal would narrow Rule 14a-8(i)(8)'s election exclusion to permit the inclusion of shareholder proposals to amend a company's governing documents to provide for a shareholder nomination process or related disclosure, if such proposals are not otherwise excludable under Rule 14a-8. This would essentially roll back the SEC decision to allow the exclusion of such shareholder proposals in 2007.

No proposed effectiveness dates were discussed at the open meeting.

The SEC was split on whether to approve this proposal. Democratic Commissioners Elisse Walters and Luis Aguilar and Chairman Mary Schapiro supported the proposal, while Republican Commissioners Kathleen Casey and Troy Paredes voted against the proposal. One of Commissioner Casey and Paredes' key concerns is whether establishing a one-size-fits-all, federal system of corporate governance over a more individualized, "private ordering" of proxy access initiatives is appropriate. Commissioner Paredes pointed to the adoption of majority voting in director elections as an example of how efficient this private ordering can be, noting the speed with which majority voting has become standard among many corporations and also how different majority voting standards have developed to meet different company needs. Both Commissioners also pointed to recent amendments in North Dakota and Delaware corporation laws to address proxy access, among other things, as evidence that this private ordering was under way. Finally, Commissioners Casey and Paredes questioned the SEC's authority to impose proxy access. We note that Senators Charles Schumer of New York and Maria Cantwell of Washington have introduced legislation in the form of the Shareholder Bill of Rights Act of 2009 that would expressly give the SEC authority to establish a proxy access regime.

The above summary is based on oral discussions from the May 20th open meeting and the SEC's press release on this development. The exact wording of the rule proposal will not be known until it is published, at which time we will update you on that development. The proposal will also be subject to a comment period before final adoption.

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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 addresses in this memorandum may be addressed to Tarun M. Stewart (212-373-3567), Judith R. Thoyer (212-373-3002) and Frances F. Mi (212-373-3185).