

**SEC PROPOSES “PROXY ACCESS” RULES TO FACILITATE
DIRECTOR NOMINATIONS BY SHAREHOLDERS**

Citing the current economic crisis and the erosion of investor confidence in the management practices of certain companies, the Securities and Exchange Commission (the “SEC”) recently proposed changes to the federal proxy rules to facilitate director nominations by shareholders.¹ According to the SEC, providing greater shareholder involvement in the nomination process will lead to increased accountability and responsiveness of companies and boards of directors to shareholder interests, helping to restore investor confidence. These controversial proposed rules (the vote proposing the amendments was 3-2 along party lines) follow years of debate as to whether, and to what extent, shareholders should have the right to place competing nominees for directorships in a company’s proxy materials.

The proposed rules would, if adopted, make two significant changes to the federal proxy rules pursuant to a new Rule 14a-11 and an amended Rule 14a-8(i)(8) under the Securities Exchange Act of 1934 (the “Exchange Act”). The new rules would, under certain circumstances, require most Exchange Act reporting companies to include in their proxy materials:

- director nominees proposed by a shareholder or group of shareholders; and
- shareholder proposals to amend the company’s governing documents regarding nomination procedures or disclosures related to shareholder nominations.

The SEC is also proposing changes to certain of its other rules and regulations, and is adding exemptions to its proxy rules and beneficial ownership reporting requirements, in connection with the proposed proxy access provisions. In addition, because Rule 14a-11 is not intended to preclude states or companies from granting shareholders the right to include their nominees in a company’s proxy materials,² the SEC is proposing new Rule 14a-19, which would impose disclosure requirements substantially similar to those under Rule 14a-11 when shareholder nominees are submitted for inclusion in a company’s proxy statement pursuant to applicable state law or a company’s governing documents.

¹ See *Facilitating Shareholder Director Nominations*, Securities Exchange Act of 1934 Release No. 60089 (June 10, 2009) (the “Release”), available at <http://www.sec.gov/rules/proposed.shtml>.

² Delaware has recently added Section 112 to its General Corporation Law, effective August 1, 2009, which allows a company’s bylaws to include a provision requiring the inclusion of a shareholder’s nominees in the company’s proxy materials. Section 112 provides a list of permissible conditions that may be included in such a bylaw in order to limit the scope of the right.

Comment Period

Throughout the Release, the SEC asks hundreds of questions seeking input as to the proposed rules and possible variations on them, raising numerous policy and technical issues. As with previous proposals for proxy access and to amend Rule 14a-8's exclusion of election-related shareholder proposals, we expect heavy comments from both shareholder groups and the corporate community. Comments are due by August 17, 2009.

The Proposed Changes

New Exchange Act Rule 14a-11

Under proposed Rule 14a-11, companies would be required, under certain circumstances, to include shareholder nominees for director in their proxy materials for annual or special meetings at which directors are to be elected. This requirement would apply unless state law or a company's governing documents (which must be consistent with state law) prohibits shareholders from nominating directors. Rule 14a-11 would apply to all companies subject to the proxy rules under the Exchange Act (including investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act")), other than companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Exchange Act.³

- (a) **Number of Shareholder Nominees/Directors.** As proposed, a company would be required to include in its proxy materials no more than the greater of one shareholder nominee or the number of shareholder nominees that represents 25 percent of the company's board of directors (with any fraction rounded down). Any director previously elected as a shareholder nominee pursuant to Rule 14a-11 and whose term of office extends past the date of the shareholder meeting would count toward that total. If multiple qualifying nominations are made, they would be honored on a "first-come, first-served" basis, up to the maximum number, rather than based on the size of the nominating shareholder's stake in the company, as was proposed in 2003.
- (b) **Stock Ownership Requirements.** To be eligible to nominate directors under proposed Rule 14a-11, a shareholder or group of shareholders must:

- Beneficially own, as of the date of the shareholder notice on new Schedule 14N:

³ Foreign private issuers are not subject to the proposed rule because they are exempted from the SEC's proxy rules under Exchange Act Rule 3a12-3 [17 CFR 240.3a12-3].

- for large accelerated filers,⁴ and registered investment companies with net assets of \$700 million or more, at least 1% of the company's voting securities;
- for accelerated filers, and registered investment companies with net assets of \$75 million or more but less than \$700 million, at least 3% of the company's voting securities; and
- for non-accelerated filers, and registered investment companies with net assets of less than \$75 million, at least 5% of the company's voting securities;
- Have beneficially owned such securities continuously for at least one year as of the date of the shareholder notice on Schedule 14N; and
- Represent that it intends to continue to own those securities through the date of the annual or special meeting.

Proposed Rule 14a-11 would permit shareholders to aggregate their securities with those of other shareholders in order to meet the applicable ownership threshold necessary for requiring inclusion of nominees in a company's proxy materials.

(c) ***New Schedule 14N.*** To take advantage of proposed Rule 14a-11, the nominating shareholder or group must provide to the company and file with the SEC a notice on new Schedule 14N. In addition to requiring disclosure about the nominee or nominees to be included in the company's proxy materials, the Schedule 14N must:

- Include a certification by the nominating shareholder or group that it does not hold its securities for the purpose or with the effect of changing control of the company or to gain more than a limited number of seats on the board;
- Be filed by the nomination deadline under the company's advance notice provision or, where no such provision is in place, no later than 120 calendar days before the date that the company mailed its proxy materials for the prior year's annual meeting, except that if a company did not hold an annual meeting the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, then the

⁴ "Large accelerated filers" have an aggregate worldwide market value of voting and non-voting common equity held by non-affiliates of \$700 million or more, as of the last business day of the company's most recently completed second fiscal quarter. "Accelerated filers" have an aggregate worldwide market value of voting and non-voting common equity held by non-affiliates of \$75 million or more, but less than \$700 million, as of the last business day of the company's most recently completed second fiscal quarter. Large accelerated filers and accelerated filers must also meet certain other conditions provided in Exchange Act Rule 12b-2, including having been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for at least twelve calendar months.

nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials;⁵ and

- Include disclosure about the amount and percentage of securities owned by the nominating shareholder or group, length of ownership of such securities, the nominating shareholder's or group's intent to continue to hold the securities through the date of the meeting as well as its intent with respect to continued ownership after the election and certain other information regarding the nominating shareholder or group. The nominating shareholder may also include in its Schedule 14N a statement in support of its nominees, not to exceed 500 words, which the company would be required to include in its proxy statement.

(d) **Director Nominee(s).** The nominating shareholder or group would be required to represent that each shareholder nominee satisfies the “bright-line” independence requirements of the national securities exchange or national securities association rules applicable to the company, if any, but would not be required to satisfy those elements of any such rule that impose an independence standard requiring a subjective determination by the board or a group or committee of the board.⁶ The nominating shareholder or group also would be required to represent that there are no relationships or agreements between the nominee or nominees and the company and its management, or between the nominating shareholder or group and the company and its management. Proposed Rule 14a-11 does not include any limitations on relationships between the nominating shareholder and its nominee.

(e) **Process and Timing for Excluding Shareholder Director Nominations.** Within fourteen (14) calendar days after the company's receipt of the nominating shareholder's or group's notice on Schedule 14N, the company must notify the nominating shareholder or group of any determination not to include the nominee or nominees and the basis for their exclusion. Within fourteen (14) calendar days after the nominating shareholder's or group's receipt of the company's exclusion notice, the nominating shareholder would be required to respond and, if permitted by the proposed rule, correct any eligibility or procedural deficiencies identified in that notice. No later than eighty (80) calendar days before the company files its definitive proxy statement and form of proxy with the SEC, the company must provide to the SEC and to the nominating shareholder or group notice of any intent to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination. The nominating shareholder or group would have

⁵ A proposed addition to Form 8-K, Item 5.07, would require a company to disclose the date by which this notice is due if the company did not hold an annual meeting the prior year or has changed the date of its next annual meeting by more than 30 days from the date of the prior year's annual meeting.

⁶ For investment companies, the nominating shareholder or group must instead represent that no nominee is an “interested person” of the investment company as defined in Section 2(a)(19) of the Investment Company Act.

fourteen (14) calendar days to respond to the company's notice. Following these submissions, the SEC staff would, at its discretion, provide to the company and the nominating shareholder or group an informal statement of its views in the form of a no-action letter. Finally, no later than thirty (30) calendar days before the company files its definitive proxy statement and form of proxy with the SEC, the company must notify the nominating shareholder or group whether it will include or exclude the nominee or nominees. The exclusion of a shareholder nominee by a company when that exclusion is not permitted would be a violation of Rule 14a-11.

(f) ***Prohibition on Slate Voting.*** Under proposed Rule 14a-11, if a shareholder nominee is included in a company's proxy materials, the proxy card cannot provide to shareholders the customary option of voting for all company nominees as a group. Instead, each nominee would have to be voted on separately.

(g) ***Liability Provisions.*** A nominating shareholder or group relying on proposed Rule 14a-11, an applicable state law provision, or a company's governing documents to include a nominee in company proxy materials would be liable for any materially false or misleading statement in its Schedule 14N that is included in the company's proxy materials. Conversely, the proposed rules provide that the company would not be responsible for any such information included in its proxy statement, except where the company knows or has reason to know that the information is false or misleading. In addition, the proposed rules provide that any such shareholder-supplied information included in a company's proxy statement would not be incorporated by reference into any filing under the Securities Act of 1933, the Exchange Act or the Investment Company Act unless the company determines to incorporate that information by reference specifically into that filing.

Amended Exchange Act Rule 14a-8(i)(8)

Exchange Act Rule 14a-8 provides shareholders with an opportunity to place a proposal in a company's proxy materials for a vote at an annual or special meeting of shareholders. However, under current Rule 14a-8(i)(8), a company may exclude shareholder proposals concerning director elections.⁷ In interpreting this provision, the SEC took the position in 2007 that Rule 14a-8(i)(8) permits exclusion of a proposal that would establish a procedure that might result in a contested board election.

Under the proposed amendment to Exchange Act Rule 14a-8(i)(8), companies would be precluded from relying on Rule 14a-8(i)(8) to exclude from their proxy materials shareholder proposals by qualifying shareholders that would amend, or that request an amendment to, a company's governing documents regarding nomination procedures or disclosures related to

⁷ Rule 14a-8(i)(8) provides that a company need not include a proposal that "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election."

shareholder nominations, provided that the proposal does not conflict with proposed Rule 14a-11. Among other things, Rule 14a-8(i)(8), as proposed to be amended, would allow shareholders to include in a company's proxy materials proposed bylaw provisions that would afford proxy access to shareholders under conditions other than those permitted under proposed Rule 14a-11. However, to the extent such a proposal would, if adopted, prevent a qualifying shareholder from making a nomination under Rule 14a-11, that proposal could not be included under Rule 14a-8(i)(8), as proposed to be amended, because it would conflict with Rule 14a-11.

Related Proposals

In connection with these proposals, the SEC has proposed a number of related changes, including exemptions from the proxy rules and Schedule 13G filing requirements.

While the SEC's proxy access proposal only allows a nominating shareholder or group to include in the company's proxy statement a supporting statement of 500 words, the SEC has proposed changes to its proxy rules to ensure that the nominating shareholder or group can employ other means of soliciting for its nominees without violating the proxy rules. As a result of these proposed changes, the nominating shareholder or group would be able to distribute, at its own cost, letters, press releases and other written solicitations to the same extent as if it was engaging in an election contest without relying on Rule 14a-11.

The SEC has also proposed changes to its Schedule 13G filing requirements to reflect its belief that shareholders or groups that would otherwise be eligible to file beneficial ownership reports on Schedule 13G rather than Schedule 13D (including groups that form in order to meet the Rule 14a-11 eligibility requirements) should not lose this eligibility solely as a result of engaging in nominating and soliciting activities, or as a result of the election of one or more of their nominees. For most Schedule 13G filers, who file under Rule 13d-1(b) or Rule 13d-1(c), there is a requirement that the filer not have acquired its shares with the purpose or effect of changing or influencing control of the company. Accordingly, the SEC is proposing to modify these requirements to carve out any activities undertaken solely in connection with a nomination under Rule 14a-11.

Looking Forward

It is widely believed that the SEC will seek to adopt final proxy access rules in time for the 2010 proxy season. This timing, however, is uncertain given the large number of questions on which the SEC is seeking comment and the high volume of comments expected to be received on this controversial proposal.

If adopted substantially in the form proposed, the SEC's proxy access proposals are likely to have a profound effect on the election of corporate directors and corporate governance. Today, corporate boards choose the director nominees whose candidacies will be funded by the company, and contested elections are relatively few due to the significant cost of mounting an election contest and the reality that such costs are unlikely to be reimbursed unless a shareholder's nominees are elected and represent a majority of the board or the shareholder and

company enter into a settlement providing for expense reimbursement. If these proposals are adopted, non-control election contests are likely to become more frequent due to the reduced costs shareholders will have to bear in order to field alternative candidates. It remains to be seen whether the governance improvements sought by the SEC will follow.

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If you have any questions regarding these proposed SEC rules or would like to comment on the proposals, please contact Serge Benchetrit (212-728-8798, sbenchetrit@willkie.com), Jeffrey S. Hochman (212-728-8592, jhochman@willkie.com), Michael A. Schwartz (212-728-8267, mschwartz@willkie.com) or the Willkie attorney with whom you regularly work.

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