

# ClientAlert

## Capital Markets/Securities

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### Proxy Access—End Game for Now

On September 7, 2011, the Securities and Exchange Commission (the “**SEC**”) announced that it would not seek a rehearing of the US Court of Appeals for the DC Circuit decision vacating the SEC’s proxy access rules, nor appeal the decision to the US Supreme Court. The proxy access rules were adopted on August 25, 2010. In the announcement, SEC Chairman Mary Schapiro indicated that she remains “committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards” but stated that the SEC would “carefully consider and learn from the Court’s objections” before taking further steps. A chronology of the proxy access process is attached to this Client Alert.

The SEC’s announcement brings to a close—for now—one of the most controversial rules ever adopted by the agency. Nevertheless, activist shareholders can take some solace, and companies should be aware, that a portion of the SEC’s rules that were not the subject of the Court’s decision survive intact and leave open the possibility of proxy access being proposed by shareholders on a company-by-company basis.

#### The Survival of Private Ordering

By way of reminder, the rules adopted by the SEC on August 25, 2010 (a) required companies to include director nominees of eligible shareholders in company proxy materials pursuant to a new Rule 14a-11 (the “**Mandatory Proxy Access Rule**”); and (b) enabled shareholders to submit proposals for inclusion in a company’s proxy statement pursuant to Rule 14a-8(i)(8) seeking to amend provisions in the company’s organizational documents relating to proxy access (the “**Private Ordering Rule**”). The Private Ordering Rule was necessary because, in 2007, the SEC had adopted an amendment to Rule 14a-8(i)(8) permitting a company to exclude from its proxy materials any proposal relating “to a nomination or an election for membership on the company’s board of directors... or a procedure for such nomination or election.”

Although the Business Roundtable lawsuit did not challenge the Private Ordering Rule, the SEC voluntarily stayed its effective date when it stayed the effective date of the Mandatory Proxy Access Rule. That stay will expire on the date that the Court’s decision is finalized, which is expected to be September 13, 2011. As a result, shareholders will have the opportunity to establish proxy access standards on a company-by-company basis through the Rule 14a-8 shareholder proposal process.



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Several organizations, including the Council of Institutional Investors and ABA's Business Law Section, urged the SEC to continue the stay of the Private Ordering Rule arguing that, because it was intended to operate in conjunction with the now invalidated Mandatory Proxy Access Rule, the SEC should evaluate and, if deemed appropriate, clarify how the amendments operate in the absence of the Mandatory Proxy Access Rule. In fact, the SEC initially determined to stay the effectiveness of the Private Ordering Rule at the same time that it stayed the Mandatory Proxy Access Rule stating that "it is consistent with what justice requires to stay the effectiveness of the [Private Ordering Rule] adopted contemporaneously with [the Mandatory Proxy Access Rule] because the amendment to [the Private Ordering Rule] was designed to complement [the Mandatory Proxy Access Rule] and is intertwined, and there is a potential for confusion if the amendment to [the Private Ordering Rule] were to become effective while [the Mandatory Proxy Access Rule] is stayed."

### **What Might Private Ordering Mean for Public Companies?**

Under the Private Ordering Rule, companies may see an increase in proposals from shareholders eligible to rely on Rule 14a-8(i)(8) seeking to institute a shareholder nomination regime via binding bylaw amendments. In fact, the Private Ordering Rule may have a greater impact on director elections than the Mandatory Proxy Access Rule because the eligibility thresholds in the Mandatory Proxy Access Rule would have limited significantly the ability of shareholders to use its provisions, whereas the eligibility requirements for shareholders to use Rule 14a-8—generally, ownership of shares with a value of at least US\$2,000 for at least one year—are more easily met.

Under Rule 14a-8, a shareholder proposal must be submitted to a company no later than 120 days in advance of the anniversary of the release date for the prior year's proxy materials, which for calendar year companies typically falls in November or December. Therefore, eligible shareholders intending to submit shareholder access proposals will need to do so relatively soon if they wish to include such proposals under Rule 14a-8 for the upcoming proxy season.

This timing also means that companies should begin preparing for the possible submission of such proposals. Proactive steps that could be considered by public companies to prepare for the private ordering regime include engaging with shareholders to identify and address, among other things, any concerns related to director nominations and performance, identifying any large and active shareholders and determining what issues they are concerned about, and educating nominating committees and other board members about the possibility of such proposals. Public companies should also review their bylaws to ensure that they provide an effective advance notice mechanism for shareholder proposals outside of Rule 14a-8 as well as procedures for shareholder nominations of directors, including requiring disclosure of relationships, financial or otherwise, a proponent and its affiliates might have with its director nominees.

Finally, with the invalidation of the Mandatory Proxy Access Rule, the Private Ordering Rule will be operating in an entirely different context than was originally contemplated. For example, when evaluating the potential effect of the Private Ordering Rule on the smaller companies, the SEC concluded that there was "no reason to expect that the [Private Ordering Rule] will substantially increase the number of shareholder proposals to smaller companies and likely will have little impact on small entities." However, absent the opportunity to submit director nominations pursuant to the Mandatory Proxy Rule, it is not unreasonable to expect that shareholders will pursue private ordering alternatives more aggressively than might otherwise have been the case.

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## Chronology of Proxy Access

- On June 10, 2009, the SEC proposed fundamental changes to the federal proxy rules that would (a) require companies to include shareholders' director nominees in company proxy materials in certain circumstances (the "**Mandatory Proxy Access Rules**"); and (b) enable shareholders to submit for inclusion in a company's proxy statement proposals pursuant to Rule 14a-8 seeking to amend provisions in the company's bylaws relating to proxy access standards (the "**Private Ordering Rules**").
- On July 21, 2010, the Dodd-Frank Act became effective. Section 971 of the Act amended Section 14(a) of the Securities Exchange Act of 1934 to expressly authorize (although not require) the SEC to adopt proxy access rules and to set the terms and conditions of shareholder access.
- On August 25, 2010, the SEC adopted both the Mandatory Proxy Access Rules (with minor changes) and the Private Ordering Rules.
- On September 29, 2010, the Chamber of Commerce and Business Roundtable filed a petition with the US Court of Appeals for the DC Circuit challenging the Mandatory Proxy Access Rules.
- On October 4, 2010, the SEC exercised its discretion to stay both the Mandatory Proxy Access Rules and the Private Ordering Rules (although they were not subject to challenge) pending resolution of the petition.
- On July 22, 2011, the US Court of Appeals for the DC Circuit vacated the Mandatory Proxy Access Rules stating that the SEC had "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments" and "contradicted itself."

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