CLEARY GOTTLIEB Alert Memo

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Issues Raised by New Proxy Access Proposals by SEC and Senate Bill

The SEC, by a 3-2 vote on May 20, 2009, proposed new rules to provide shareholders with direct access to the proxy statements of public companies for the purpose of nominating a limited number of directors. In parallel, Senators Schumer and Cantwell proposed a bill that would add a new subsection to the Exchange Act, entitled "Confirmation of Commission Authority on Shareholder Access to Proxies for Board Nominations," that would require the SEC to promulgate proxy access rules.

Although the SEC proposal is not yet available, the extensive and heated discussion at the open meeting on May 20, together with a press release the SEC issued later in the day, provide visibility on the proposal's key terms and issues. In view of Chairman Schapiro's frequent references to the importance of adopting proxy access rules, even with two Commissioners objecting, and the current political momentum, the final proxy access rules may well be effective in time for the 2010 proxy season. The next steps will be the SEC's publication of a formal proposing release followed by a 60-day comment period, as well as possible progress on proxy access legislation in the Congress.

The most delicate issues that the new SEC proposal raise are whether as a policy matter the rule ventures into an area of substantive shareholder rights that has traditionally been within the realm of, and is best left to, state corporate law and whether as a legal matter the SEC has the authority under the proxy provisions of the Exchange Act to require proxy access.

Currently, Delaware corporate law permits the adoption of proxy access bylaws, North Dakota corporate law mandates proxy access, and the Committee on Corporate Laws of the ABA Section of Business Law has approved on first reading an amendment to the Model Business Corporation Act, which is the blueprint for many states' corporation laws, permitting adoption of such bylaws. Further, a handful of public companies have voluntarily implemented some form of enhanced shareholder access to the nominating process. The SEC proposal, as described, would effectively trump any state law or provision in charters or bylaws that conflicts with the new rule. In addition, the proposal contemplates reversing the current bar under Rule 14a-8 to shareholder proposals for proxy access bylaws, but any such shareholder proposal would be permitted under an amended Rule 14a-8 only if it proposed greater rights of access for shareholders than the SEC's new proxy access rules.

The proposal and Chairman Schapiro's opening statement at the open meeting, as well as other comments at the meeting, make clear that the supporters of the proposal on the Commission believe the amendments advance important policy objectives and fall within the Commission's broad authority over proxy statements. However, the forceful dissents at the open meeting by Commissioners Casey and Paredes raise the issue not only of whether the proxy access rules will make good policy in view of concerns for federalism, but also whether the SEC is overstepping its authority. Indeed, one rationale behind the Schumer/Cantwell bill would appear to be to cut off arguments that the SEC is acting beyond its existing Exchange Act authority.

Substantively, the new proposals by the SEC and the Senators would provide for significantly broader rights of access than the last SEC proposal directly addressing proxy access rights, which was published in 2003 and debated for nearly two years.

Subject Companies

- The SEC proposal would cover all companies subject to the SEC proxy rules – i.e., all Exchange Act reporting companies (including investment companies) other than foreign private issuers (which are not subject to the proxy rules) and debt-only registrants.

No Trigger Event Requirement

- The SEC's 2003 proposal limited proxy access to subject companies where "triggering events", indicative of shareholder dissatisfaction, had occurred. The new SEC proposal drops this concept.

Eligibility of Shareholders to Submit Nominees

- The Senate bill provides that no shareholder may take advantage of proxy access rules unless it has been at least a 1% beneficial owner for at least two years preceding the annual meeting in question.

- By contrast, the SEC proposal sets minimum holding requirements for only one year preceding a shareholder submission of a nominee, combined with a requirement to certify intent to continue to hold until the meeting at which the election in question will occur.

- The SEC proposal uses a tiered approach to setting these minimum holding requirements: 1% for "large accelerated filers" (companies with a worldwide common equity market value of at least $700 million), 3% for "accelerated filers" (companies with a worldwide common equity market value of at least $75 million but less than $700 million) and 5% for "non-accelerated filers"

(companies with a worldwide common equity market value of less than $75 million).

- Both the Senate bill and the SEC proposal would permit shareholders to form "groups" for purposes of satisfying these thresholds.

- The SEC proposal provides that the nominating shareholder will not lose its Schedule 13G eligibility by virtue of taking advantage of the proxy access rules, but the shareholder must also make a representation that it is seeking neither a change of control of the company nor to nominate more than a minority of the company's directors. There would be liability for misrepresenting these intentions; however, as evidenced by the number of 13G filers who have shifted to 13D status in recent years, it is not uncommon for hedge funds and other shareholders initially to take the position that they have "passive" intent but to change that position and become insurgents at a later date.

Number of Nominees Permitted

- The maximum number of alternative nominees permitted would be 25% of the total number of board seats, except the maximum number would be one seat for boards with fewer than eight directors. During the open meeting, the SEC staff did not describe how this provision would work in the context of a staggered board.

- Should nominations from all eligible shareholders exceed the maximum number of nominees entitled to access under the new rule, a "first-in-time" rule would appear to allow the first eligible shareholder that provides timely notice to include the maximum number of nominees. By contrast, the 2003 SEC proposal required companies to give preference to nominees from the shareholder (or group) having the largest beneficial ownership.

- Eligible shareholders would have to submit nominees, together with detailed disclosure akin to that required for proxy contests and many advance notice bylaws, by no later than 120 days before the anniversary of the mailing of the previous year's proxy statement – a timing requirement that implies a deadline in late autumn 2009 for adoption of the proposed rules to assure applicability to the 2010 proxy season. The staff stated at the open meeting that it is still contemplating whether to prohibit nominations occurring more than a specified period in advance of the annual meeting.

Eligibility Criteria for Nominees

- Nominees must meet the "independence" criteria of the applicable exchange, but, in contrast to the SEC's 2003 proposal, need not be independent of the nominating shareholder.

- Neither the nominating shareholder nor any member of the nominating shareholder group may have any direct or indirect agreement with the company regarding the nomination of the nominee.

For further information on this subject, please contact any of your regular contacts at the firm or any of our partners and counsel listed under "Capital Markets," "Corporate Governance" or "Mergers, Acquisitions and Joint Ventures" in the "Our Practice" section of our website (http://www.clearygottlieb.com).

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