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Rule 14a-8 Amendments Allowing Shareholder Proposals On Proxy Access To Go Into Effect Shortly

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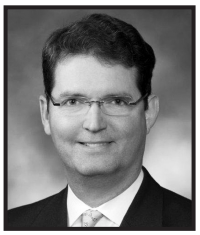
On September 15, 2011, the Securities and Exchange Commission (SEC) issued a release announcing that amendments to Rule 14a-8 allowing shareholder proposals on proxy access will become effective as soon as the SEC's release is published in the *Federal Register*. As a result, companies soon will be required to include in their proxy materials shareholder proposals seeking to give shareholders direct access to company proxies for inclusion of their director nominees.



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The Rule 14a-8 amendments were originally adopted in 2010 in conjunction with the SEC's adoption of a universal proxy access rule. Rule 14a-11 would have required all companies to provide shareholders with direct access to company proxy materials for their director nominees. The SEC stayed the effectiveness of both rule changes pending resolution of litigation brought by business groups challenging Rule 14a-11. This past summer, a federal court struck down Rule 14a-11, and the SEC announced last week that it would not seek a rehearing or pursue an appeal. Consequently, when the court's decision became final on September 14, 2011, the SEC's stay of the Rule 14a-8 amendments, which were not challenged in the litigation, was automatically lifted, and the SEC thereafter issued a release announcing that the Rule 14a-8 amendments would become effective upon publication of the release in the *Federal Register*. In this alert we discuss the amendments to Rule 14a-8 and their likely effect on companies for the 2012 proxy season.

What are the amendments to Rule 14a-8?

Rule 14a-8, which requires a company to include certain shareholder proposals in the company's own proxy statement, has historically allowed companies to omit shareholder proposals that relate to the nomination or election of directors from their proxy materials. Under the amendments to Rule 14a-8, companies will be required to include any shareholder proposals that would amend, or request an amendment to, a company's governing documents concerning director nomination procedures or other director nomination disclosure provisions, provided the proposals do not otherwise conflict with SEC proxy rules or applicable law. Only shareholders who meet the current eligibility requirements of Rule 14a-8 (which require that the shareholder own at least $2,000 in market value, or 1 percent, whichever is less, of the company's shares for at least one year) may submit such proposals.

These Rule 14a-8 amendments give shareholders the flexibility to propose amendments that would establish proxy access standards on a company-by-company basis, rather than the "one-size-fits-all" approach as provided in Rule 14a-11. Although some companies may challenge such individual proxy access proposals as impermissible under state law, Delaware amended its laws in 2009 to expressly allow (but not require) Delaware corporations to adopt bylaws that grant shareholders access to the company's proxy materials to nominate directors, thereby making this challenge moot for Delaware corporations.

Although the amendments narrow a company's ability to exclude proposals that relate to the nomination or election of directors from Rule 14a-8, the SEC continues to believe that, under certain circumstances, companies should have the right to exclude

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proposals related to particular elections and nominations for directors from company proxy materials where such proposals could result in an election contest between company and shareholder nominees. To that end, the SEC also amended Rule 14a-8(i)(8) to codify certain prior SEC staff interpretations and make clear that a company may exclude a proposal if the proposal

- would disqualify a nominee who is standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, business judgment or character of one or more nominees or directors;
- seeks to include a specific individual in the company's proxy materials for election to the board of directors, or
- otherwise could affect the outcome of the upcoming election of directors.

How will the amendments to Rule 14a-8 impact the 2012 proxy season?

It is difficult to predict how many companies will receive proxy access shareholder proposals in the 2012 proxy season. Rule 14a-8 requires a proponent to submit a proposal no later than 120 calendar days before the anniversary of the date on which the company's proxy statement for the prior year's annual meeting was released to shareholders. For most calendar-year companies, the deadline for the 2012 proxy season will fall somewhere between November 2011 and January 2012. So, eligible shareholders still have time to submit proxy access proposals for the upcoming proxy season.

While some analysts have speculated that prodigious use of Rule 14a-8 might undermine continuing efforts by activists to have some form of universal proxy access ultimately adopted,[1] the Council of Institutional Investors announced last week that it "welcome[s] the lifting of the stay" and warned that "Council member funds and the broader investor community are ready and willing to seek access to the proxy to nominate directors judiciously, at companies where boards have been asleep at the switch or chronically unresponsive to shareholder concerns."[2] Consequently, at least those companies with ongoing corporate governance issues should be prepared for the possible submission of proxy access proposals. And if the history of other investor-led governance initiatives, such as majority voting, is any guide, the most likely targets in the first year of proxy access will be large, higher-profile companies.

It is also likely that shareholder proposals submitted under Rule 14a-8 will have lower thresholds for proxy access than those imposed by Rule 14a-11. Rule 14a-11 would have given proxy access only to shareholders who have continuously held at least 3 percent of the voting power of a company's securities for three consecutive years and would have capped the total number of shareholder nominees at 25 percent of the board. Many institutional investors have favored a lower ownership threshold (such as 1 percent) at larger-cap companies and a one- or two-year holding period.

It is also possible that the Rule 14a-8 amendments could be challenged in court on the same grounds that proved fatal to Rule 14a-11. The D.C. Circuit Court of Appeals strongly criticized the SEC's approach in adopting Rule 14a-11, holding that the SEC had acted "arbitrarily and capriciously" and failed to satisfy its statutory obligations to determine the effect of the new rule upon efficiency, competition and capital formation. Among other things, the court found that the SEC had failed to adequately demonstrate the economic benefits, had discounted the costs, had neglected to support various predictive judgments, and had not provided sufficient empirical data or support for the supposed benefits of the rule. It is possible that the Rule 14a-8 amendments might be similarly challenged.

What should companies do now?

We expect most companies to simply sit tight and closely monitor developments as they unfold. However, companies that are likely targets of proxy access proposals should begin evaluating their options now. Certainly any company that receives a proxy access proposal should take it seriously. In 2007, before the SEC clarified that Rule 14a-8 did not then permit proxy access proposals, proxy access proposals at United Health and Hewlett-Packard each received over 40 percent shareholder support. And a majority of shareholders voted in favor of a proxy access proposal at Cyro-Cell International, a small-cap firm.

Companies that are actual or likely targets of a proxy access proposal should consider, among other things the following:

- The prospects for the proposal's success. A company should assess its shareholder base and investor relations history, as well as the likely recommendations of the proxy advisory firms. ISS previously had evaluated proxy access proposals on a company-by-company basis, but will likely formulate a more specific policy for the upcoming proxy season.
- Whether the company should proactively implement its own proxy access mechanism. The board of directors could adopt, or propose to shareholders for their consideration, a bylaw amendment that contains higher thresholds or other restrictions than those likely to be proposed by activists. A company that takes one of these approaches, however, may face a shareholder proxy access proposal that contains different thresholds. In such case, a company that has implemented its own proxy access mechanism may argue that the proposal can be excluded because proxy access has already been substantially implemented by the company. It is unclear, however, how the SEC will treat this argument. Historically, in the context of proposals to give shareholders a right to call a special meeting, the SEC has rejected the substantial implementation argument because of the difference in ownership thresholds from what the company had implemented versus the threshold in the proposal. On the other hand, in situations in which a company has placed on the ballot its own competing proposal after receiving a shareholder proposal, the company has often been successful in excluding the shareholder proposal on the basis that it conflicts with the company proposal even though the ownership thresholds differ. It is unclear, however, given the SEC's support of proxy access, whether companies can expect similar outcomes in their efforts to exclude shareholder proxy access proposals.
- Whether the company can exclude the proposal on other grounds. Potential grounds for exclusion include the proponent's failure to satisfy the eligibility or procedural requirements of the rule. Also, a proposal can be excluded on substantive grounds, including if it conflicts with state law or is vague and misleading. Again, however, given the SEC's support of proxy access, company efforts to exclude shareholder proxy access proposals may have limited success except in clear cases.

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[1] Proxy access proponents continue to urge the SEC to adopt a mandatory rule. On September 13, 2011, a coalition of 14 pension funds and institutional investors called on the SEC "not to give up" and to issue new rules providing for universal proxy access. Calpers press release, "Investors Urge New Rule on Proxy Access" (September 13, 2011), available at http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2011/sept/proxy-access.xml. The court decision vacating Rule 14a-11 does not preclude the SEC from again proposing mandatory proxy access rules, as the decision was based on the SEC's failure to satisfy procedural requirements under the Administrative Procedures Act. In the SEC release announcing that it would not appeal the decision, SEC Chairman Shapiro stated that she "remains committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards." However, SEC reconsideration of proxy access is not expected to occur in time for the 2012 proxy season in view of the strong criticism leveled by the court of the SEC's procedures and the large body of other rule-making on the SEC's agenda.

[2] Statement of Ann Yerger, executive director of Council of Institutional Investors (September 7, 2011), available at www.cii.org.