



Amendments to Shareholder Proposal Rule Take Effect Making Way for Proxy Access Proposals

On September 20, 2011, the Securities and Exchange Commission published a [notice](#) in the *Federal Register* announcing that its previously-adopted amendments to Exchange Act Rule 14a-8, the shareholder proposal rule, are now effective. The amendments require public companies to include in their proxy statements, under certain circumstances, shareholder proposals seeking to establish procedures in the company's governing documents for including a shareholder's director nominees in the company's proxy materials. Accordingly, shareholders may now submit shareholder proxy access proposals for inclusion in 2012 proxy statements.

Current Status of Proxy Access Rules

The Dodd-Frank Wall Street Reform and Consumer Protection Act provided the SEC with explicit authority to adopt rules permitting shareholders to use public companies' proxy materials to nominate directors. On August 25, 2010, the SEC, by a 3-2 vote, adopted Exchange Act Rule 14a-11 to implement a universal system of "proxy access," requiring nominations and supporting statements made by certain shareholders to be disclosed in a public company's proxy materials. The SEC contemporaneously adopted amendments to Rule 14a-8 to permit shareholders to propose a system of proxy access on a company-by-company basis.

Rule 14a-11 and the amendments to Rule 14a-8 were to take effect on November 15, 2010. On September 29, 2010, the Chamber of Commerce and Business Roundtable filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit seeking review of Rule 14a-11, alleging, among other things, that the SEC adopted the rule in violation of the Administrative Procedure Act.¹ The petitioners also filed with the SEC a motion to stay the effectiveness of Rule 14a-11 pending review by the D.C. Circuit, which the SEC granted on October 4, 2010. The SEC concurrently stayed until the resolution of the litigation the effectiveness of the Rule 14a-8 amendments, even though such amendments were not challenged.

On July 22, 2011, the D.C. Circuit invalidated Rule 14a-11, holding that the SEC acted arbitrarily and capriciously in adopting the rule and failed to thoroughly analyze the rule's economic effects, both in violation of the Administrative Procedure Act. On September 7, 2011, the SEC announced that it would not seek a rehearing of the decision or appeal the decision to the U.S. Supreme Court. The future of Rule 14a-11 or any similar universal proxy access system is uncertain.

¹ *Business Roundtable et al v. Securities and Exchange Commission*, No. 10-1305 (D.C. Cir., Jul. 22, 2011).

The stay on the Rule 14a-8 amendments expired by its terms when the D.C. Circuit's judgment became final on September 14, 2011. As required by the stay order, on September 20, 2011, the SEC published a notice in the *Federal Register* announcing the effectiveness of those amendments.

At the time it issued the stay on Rule 14a-11, the SEC explained that a corresponding stay of the effectiveness of the Rule 14a-8 amendments was also justified because the rules were "intertwined." It remains to be seen whether the adoption of the Rule 14a-8 amendments will be challenged in court because of the close link with the invalidated Rule 14a-11.

Amendments to Shareholder Proposal Rule

Rule 14a-8(i)(8) previously provided a broadly-stated "election exclusion" that allowed public companies to exclude any shareholder proposal that "relates to a nomination or an election for membership on the company's board of directors...or a procedure for such nomination or election." The Rule 14a-8 amendments narrow the categories of shareholder proposals concerning director elections that companies may exclude. Companies generally may no longer exclude shareholder proposals seeking to amend (or recommend that the board amend) the company's governing documents to establish procedures and disclosure requirements for including a shareholder's director nominees in the company's proxy materials. Companies would, however, still be able to exclude a shareholder proposal if it is otherwise excludable under Rule 14a-8 or if it:

- would disqualify a nominee up for election;
- would remove a director from office before his or her term expired;
- questions the competence, business judgment or character of a nominee or director;
- seeks to include a specific individual for election to the board of directors; or
- otherwise could affect the outcome of the upcoming election of directors.

Shareholder proxy access proposals brought under Rule 14a-8(i)(8) will be subject to the standard Rule 14a-8 eligibility requirements, which generally require only that shareholder proponents have owned at least \$2,000 in company stock for more than one year.

Backdrop of Shareholder Proxy Access Proposals

Shareholder proxy access proposals have a limited history, largely due to the ongoing controversy surrounding proxy access. In 1999, the United Brotherhood of Carpenters pension plans submitted the first proxy access proposals to dozens of companies as part of a broader initiative to advance a series of corporate governance reforms. Such proposals led to extensive dialogue with executives at the companies that were targeted.

In 2004, the American Federation of State, County & Municipal Employees submitted a proxy access proposal to American International Group, Inc. for inclusion in AIG's 2005 proxy statement. AIG excluded the proposal after receiving a no action letter from the SEC and AFSCME filed suit against AIG claiming that exclusion was improper. The U.S. Court of Appeals for the Second Circuit held that AIG could not use Rule 14a-8(i)(8) to exclude AFSCME's proposal.² However, because the Second Circuit's ruling was in direct conflict with the SEC Staff's historical interpretation of the election exclusion, the SEC amended Rule 14a-8(i)(8) in November 2007 to clarify that companies could exclude shareholder proxy access proposals.

Prior to that amendment, shareholders submitted three proxy access proposals that garnered substantial shareholder support during the 2007 proxy season. A non-binding proxy access proposal at UnitedHealth Group, Inc. did not pass

² *American Federation of State, County & Municipal Employees v. American International Group, Inc.*, 462 F.3d 121 (2nd Cir. 2006).

for lack of a majority but received over 45% support. A binding proposal at Hewlett-Packard Company also won a significant percentage of approval (nearly 43%) but would have required a 2/3 supermajority vote for passage pursuant to the company's bylaws. A non-binding proxy access proposal passed at Cryo-Cell International, Inc. The UnitedHealth and Hewlett-Packard proposals required a nominating shareholder to have owned at least 3% of the company's stock for at least two years while the Cryo-Cell proposal required 5% ownership for at least two years.

Many other corporate governance reforms have developed over the past decade that arguably lessen the need for proxy access, including (i) the elimination of broker discretionary voting in director elections; (ii) an increase in majority voting for directors; (iii) a decrease in classified boards; (iv) increased engagement with shareholders; and (v) mandatory "say on pay" votes.

Future of Shareholder Proxy Access Proposals

It remains to be seen whether shareholder activists will submit a significant number of proxy access proposals in advance of the 2012 proxy season. Large companies with a history of corporate governance-related issues are expected to be the most likely targets.

Strong support for shareholder proxy access proposals this year could pressure the SEC to implement more expeditiously a revised universal proxy access system. However, if significant numbers of shareholder proxy access proposals are filed, the arguments that a universal system of proxy access is necessary may be weakened. Alternatively, if very few shareholder proxy access proposals are filed, or if such proposals do not receive high levels of shareholder support, it may imply that proxy access is not desired by shareholders.

It is also unclear what form future shareholder proxy access proposals will take. Shareholders may propose resolutions on binding bylaw amendments or may submit non-binding, precatory proposals for votes that recommend that the board amend the bylaws to permit proxy access. Binding bylaw proposals may be subject to a supermajority shareholder vote under a company's bylaws.

Shareholders will also have to propose eligibility requirements for shareholders seeking to nominate directors. Rule 14a-11 would have required nominating shareholders to have continuous ownership of a minimum of 3% of a company's stock for at least three years. Shareholder proxy access proposals submitted for the 2012 proxy season are expected to contemplate more permissive eligibility requirements than under Rule 14a-11. This decision may be influenced in part by the policies of proxy advisory firms. Both Institutional Shareholder Services Inc. and Glass, Lewis & Co. will review shareholder proxy access proposals on a case-by-case basis. ISS's 2011 proxy voting guidelines provide that ISS will consider (i) the ownership threshold proposed in the resolution; and (ii) the proponent's rationale for the proposal at the targeted company in terms of board and director conduct. ISS may modify the guideline now that shareholder proxy access proposals will be permissible for the 2012 proxy season.

While companies can no longer rely on the election exclusion to block shareholder proxy access proposals, companies will undoubtedly attempt to exclude them on other substantive or procedural grounds. If shareholder proxy access proposals begin to receive significant shareholder support, companies may even eventually choose to offer their own management proposals with more onerous eligibility requirements (e.g., 10% minimum ownership) as a basis to exclude shareholder proxy access proposals.

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