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SEC Provides Notice of the Effective Date of Its Rule 14a-8 Amendments Permitting Proxy Access Shareholder Proposals

On September 15, 2011, the SEC issued a release to provide notice of the effective date of the amendments to Rule 14a-8, the shareholder proposal rule, which amendments will require companies to include in their proxy materials, under certain circumstances, shareholder proposals that seek to establish a procedure in the company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials.¹ The SEC's release provides that the Rule 14a-8 amendments would be effective upon publication of the release in the Federal Register which occurred on September 20, 2011.²

The Amendments to Rule 14a-8 Permitting Proxy Access Shareholder Proposals Are Now Effective

Accordingly, the amendments to Rule 14a-8 that had been previously stayed by the SEC pending the litigation challenging the SEC's Rule 14a-11 proxy access rule (but which litigation did not challenge the Rule 14a-8 amendments) are now effective. As we noted in our earlier alert, the United States Court of Appeals for the District of Columbia Circuit vacated the SEC's proxy access rule, Rule 14a-11, on July 22, 2011.³ As adopted by the SEC, Rule 14a-11 would have provided shareholders with an alternative means to nominate and elect directors as it would have required companies to include shareholder director nominees in company proxy materials in certain circumstances. In vacating Rule 14a-11, the Court held that the SEC acted "arbitrary and capricious" in promulgating Rule 14a-11 and that it failed to adequately assess the economic effects of the new rule.⁴

The Amendments to Rule 14a-8 Narrow the "Election Exclusion" under Rule 14a-8(i)(8)

Amended Rule 14a-8 substantially narrows the scope of the election exclusion under Rule 14a-8(i)(8). As adopted, companies

will no longer be able to rely on Rule 14a-8(i)(8) to exclude a proposal seeking to establish a procedure in a company's governing documents for the inclusion of one or more shareholder nominees for director in the company's proxy materials.

In addition, the amendments to Rule 14a-8 codify various prior interpretations of the SEC staff. As adopted, companies will be permitted to exclude a shareholder proposal pursuant to Rule 14a-8(i)(8) if such proposal:

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

As noted in the SEC's adopting release, a shareholder proposal would also continue to be subject to exclusion under other provisions of Rule 14a-8. For example, a proposal would be excludable under Rule 14a-8(i)(2) if its implementation would cause the company to violate any state, federal, or foreign law to which it is subject, or under Rule 14a-8(i)(3), if the proposal or supporting statement was contrary to any of the SEC's proxy rules.

In addition, a proxy access shareholder proposal, like other shareholder proposals made pursuant to Rule 14a-8, is required to meet the procedural requirements of Rule 14a-8, including the requirement that such shareholder have continuously held for at least one year at least \$2,000 in market value, or 1%, of the company's voting securities entitled to vote on such proposal, and not be subject to one of the other substantive exclusions under Rule 14a-8.

How Popular Will Rule 14a-8 Proxy Access Proposals Be in the 2012 Proxy Season?

In 2011, there was an overall decline in governance proposals submitted by shareholders. According to its Preliminary 2011 Postseason Report, for meetings held from January 1 to June 30, 2011, ISS reported that investors filed 466 governance proposals, down from 615 during the same period in 2010, and 675 in 2009.⁵

The most popular corporate governance shareholder proposals in the 2011 proxy season related to the repeal of a classified board, adoption of majority voting, authorization of shareholder action by written consent, and authorization or enhancement of the right of shareholders to call a special meeting of shareholders.⁶ Given the novelty of proxy access proposals, it is still too early to predict whether proxy access proposals made pursuant to amended Rule 14a-8 will be as popular as these other corporate governance proposals and whether proxy access proposals will become popular tools of a wide array of activist and/or institutional shareholders or—like we saw this past proxy season with respect to the numerous proposals empowering shareholders to take action by written consent or enhancing the ability of shareholders to call special meetings—will be presented by a small number of individual shareholders.

Planning for the 2012 Proxy Season

Notwithstanding the difficulty of predicting the popularity in the 2012 proxy season of proxy access proposals made pursuant to amended Rule 14a-8, companies should take steps to prepare for the possibility that they will receive proxy access proposals and contemplate how they would respond to such proposals. Even better would be for companies to take steps to anticipate which of their shareholders may be likely to submit such proposals and enter into an early dialogue with those shareholders to head off such proposals.

While some companies may seek to craft their own form of a proxy access bylaw (perhaps following the model proxy access

bylaw prepared by the American Bar Association Task Force on Shareholder Proposals⁷ or any of the various forms of model proxy access bylaws that are likely to be crafted and made publicly available by the corporate governance and/or securities bar as the 2012 proxy season approaches) and argue that they should be able to exclude the shareholder-submitted proxy access proposal on the grounds that either such proposal was already substantially implemented by the company or such proposal directly conflicts with the company's own form of proxy access proposal to be submitted to shareholders at the same meeting,⁸ it is still too early to predict how many companies will be willing to take such preemptive action. Also difficult to predict will be how the SEC would respond to a no-action letter seeking to exclude the shareholder-submitted proxy access proposal on either basis. In addition, as was seen this past proxy season with respect to many governance proposals, many of the proxy access proposals that may be submitted ultimately could be withdrawn as a result of dialogue between companies and shareholders.

Companies also need to prepare for the possibility that they might receive a proxy access proposal from shareholders that they won't be able to exclude from their proxy materials or won't be able to cause the proponent to withdraw. In that event, companies need to be prepared in advance with a strategy of how to defeat such a proposal if, ultimately, the recommendation of the company's board of directors is to recommend against such a proposal.

Conclusion—Activists Will Have a New and Potentially Useful Quiver in Their Arsenal For the 2012 Proxy Season

Notwithstanding that Rule 14a-11 will not be a factor in the 2012 proxy season, with the amendments to Rule 14a-8 now permitting the submission of proxy access proposals during the 2012 proxy season, activist shareholders will have yet another useful arrow in their quiver that companies will need to prepare for.

1. SEC, Notice of Effective Date, *Facilitating Shareholder Director Nominations: Notice of Effective Date*, Release No. 33-9259 (September 15, 2011) (available at www.sec.gov/rules/final/2011/33-9259.pdf).
2. SEC, Notice of Effective Date, *Facilitating Shareholder Director Nominations: Notice of Effective Date*, 76 Fed. Reg. 58,100 (September 20, 2011) (available at www.gpo.gov/fdsys/pkg/FR-2011-09-20/pdf/2011-24118.pdf).
3. *Business Roundtable et al v. Securities and Exchange Commission*, No. 10-1305 (D.C. Cir. Decided July 22, 2011) (available at [www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf)).
4. *Id.* at 7.
5. *Preliminary 2011 U.S. Post-Season Report*, Institutional Shareholder Services, Inc. (2011).
6. *ISS 2011 U.S. Proxy Season Scorecard*, Institutional Shareholder Services, Inc. (2011).
7. See http://meetings.abanet.org/webupload/commupload/CL410000/sitesofinterest_files/illustrative_access_bylaw.pdf.
8. See Rule 14a-8(i)(9) and Rule 14a-8(i)(10).

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