# THE SEC'S PROPOSED "PROXY ACCESS" RULES: BOON TO "ACCIDENTAL" OR "RELUCTANT" ACTIVISTS?

On June 10, 2009, the Securities and Exchange Commission (the "SEC") published for comment its proposed "proxy access" rules,[1] which are intended to facilitate director nominations by shareholders. The most significant of these initiatives, proposed Rule 14a-11, would provide that eligible shareholders or shareholder groups can require a company to include in its proxy statement and proxy card a limited number of director nominees to run in opposition to management's nominees.[2]

While proposed Rule 14a-11 has significant limitations and may not be ideally suited for traditional shareholder activists, it is likely to provide a relatively inexpensive and attractive option for "accidental" or "reluctant" activists — investors who do not consider themselves to be shareholder activists but who find themselves invested in a company where change is required and exit options are unattractive or unavailable. A successful campaign for only one or two board seats, if run on a clear-cut and well-articulated platform, can send an important message to a board of directors and catalyze change, even if it cannot force change.

## Eligibility for Using Proposed Rule 14a-11

In brief,[3] shareholders and shareholder groups would be eligible to use proposed Rule 14a-11 if:

- they have held the required percentage of the company's voting stock for at least one year, and
- they do not hold their shares for the purpose or with the effect of changing control of the company or gaining more than a limited number of seats on the board.

The required ownership percentage depends principally on the size of the company. For "large accelerated filers," which have an aggregate worldwide market value of voting and nonvoting common equity held by nonaffiliates of $700 million or more, the requisite percentage is 1% of

---

1 The SEC's proposing release, *Facilitating Shareholder Director Nominations*, Securities Exchange Act of 1934 Release No. 60089 (June 10, 2009) is available at http://www.sec.gov/rules/proposed.shtml.

2 Proposed Rule 14a-11 under the Securities Exchange Act of 1934 (the "Exchange Act"). The SEC's proposed rules would also amend current Rule 14a-8(i)(8) under the Exchange Act in order to prevent companies from excluding from their proxy materials shareholder proposals regarding nomination procedures or disclosures related to shareholder nominations.

3 A more detailed and complete description of the proposed rules may be found in our June 23, 2009 Client Memorandum, *SEC Proposes "Proxy Access" Rules to Facilitate Director Nominations by Shareholders*, available at http://www.willkie.com/firm/pubs.aspx.

the company's voting stock. For "accelerated filers," which have at least $75 million but less than $700 million in worldwide market value of voting and nonvoting stock held by nonaffiliates, the requisite percentage is 3% of the voting stock.[4] For companies that are neither large accelerated filers nor accelerated filers, the requisite percentage is 5% of the voting stock.[5]

Eligible shareholders would be able to nominate under proposed Rule 14a-11 the greater of one director or the number of directors that is equal to 25% of the board (with any fraction rounded down).[6] If multiple shareholders or groups seek to require inclusion of their nominees in the company's proxy materials and the total number of shareholder nominees exceeds the maximum number required to be included, the nominees are chosen on a "first come, first served" basis.

**Some Advantages and Disadvantages for Shareholders Using Proposed Rule 14a-11**

The overwhelming advantage of acting under proposed Rule 14a-11, as compared with engaging in a traditional proxy contest, is the significantly reduced cost resulting from the use of management's proxy statement and proxy card. By piggybacking on management's proxy materials, a shareholder avoids the need to prepare its own proxy statement and proxy card, to clear those materials through SEC review and to print and mail them. In addition, because the shareholder's nominees will be included on each proxy card distributed by management, including those sent in the company's follow-up mailings, the nominating shareholder or group will not be "forced," as a tactical matter, to match management's periodic mailings during the pendency of the proxy contest simply to ensure that shareholders have an opposition card in hand for each management proxy card received.[7]

Proposed Rule 14a-11 allows a nominating shareholder or group to include in the company's proxy statement a supporting statement in favor of its candidates of up to 500 words. Other provisions of the SEC's proxy access proposals enable a nominating shareholder or group to conduct the same wide range of soliciting activities that can be undertaken in a traditional proxy contest. But in contrast to a traditional proxy contest, where "fight letters" and proxy cards are

---

4 Large accelerated filers and accelerated filers must also meet certain other conditions of Exchange Act Rule 12b-2, including having been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for at least 12 calendar months.

5 The requisite percentages for investment companies registered under the Investment Company Act of 1940 are: for companies with net assets of $700 million or more, 1%; for companies with net assets of $75 million or more but less than $700 million, 3%; and for companies with net assets of less than $75 million, 5%.

6 For companies with staggered boards, any director who was previously elected as a shareholder nominee under proposed Rule 14a-11 and whose term extends beyond the upcoming meeting will be counted against the maximum number of nominees permitted under proposed Rule 14a-11.

7 This can be an important tactical consideration in a traditional proxy contest, where each side sends out proxy cards naming only its own slate of nominees, because the latest-dated proxy card delivered by a shareholder revokes all prior proxy cards the shareholder submits.

traditionally printed and mailed to shareholders periodically throughout the contest, a nominating shareholder can avoid the cost of printing and mailing these materials and instead disseminate them as press releases that are likely to reach a large portion of the intended audience.

The most significant disadvantages of an election campaign run under proposed Rule 14a-11 are the limited number of board seats that can be targeted and an inability to seek a change in control of the company. In many cases, these disadvantages make the proposed rule unsuitable for traditional shareholder activism, which is often characterized by an explicit or implicit threat of a change of board control or by an agenda to change the company's ownership, capitalization or structure. However, these limitations may not significantly impede the accidental or reluctant activist shareholder in pursuing in a less confrontational manner the goal of reorienting the board's priorities or addressing specific issues without remaking the company.

**The Process for Including Nominees in Management's Proxy Materials**

Assuming that a shareholder or shareholder group meets the eligibility requirements for acting under proposed Rule 14a-11 and has chosen its director nominee or nominees, the next step in securing the right to piggyback on management's proxy statement is to deliver to the company a notice on proposed Schedule 14N and to file the Schedule 14N with the SEC. Another proposed rule, Rule 14a-18, provides a deadline for delivering and filing the Schedule 14N, which is either the deadline for nomination notices under the company's advance notification bylaw or, if the company does not have such a bylaw provision, 120 days prior to the date the company mailed its proxy materials for the prior year's annual meeting.[8] Unlike advance notification bylaw provisions themselves, Rule 14a-18 as currently proposed does not specify a date before which Schedule 14N cannot be delivered. As a result, and because the first eligible shareholder who gives notice on Schedule 14N will have priority in including nominees in a company's proxy statement, it will be essential to plan well in advance and to act early in order to conduct an election contest under proposed Rule 14a-11.

If the company does have an advance notification bylaw, it will be necessary to provide notice under that provision in a timely manner in addition to delivering a Schedule 14N. However, there is substantial overlap between the contents of Schedule 14N and the requirements of most advance notification bylaws, which will likely reduce the effort in preparing this second notice. It is important to remember, though, that under most advance notification bylaws, unlike under proposed Rule 14a-11, only a record holder of stock can provide the notice. Accordingly, nominating shareholders will still have to move some shares from street name to record name or provide the nomination notice under the bylaws through the actual record holder, which typically is Cede & Co., the nominee of The Depository Trust Company.

---

[8] If the company did not hold an annual meeting the prior year or has moved the date of the upcoming annual meeting by more than 30 days from the date of the prior year's annual meeting, the Schedule 14N must be delivered and filed a reasonable time before the company mails its proxy materials. Under proposed Item 5.07 of Form 8-K, a company is required to specify this deadline in a Form 8-K filing if it did not hold an annual meeting the prior year or has moved its upcoming meeting by more than 30 days from the prior year's meeting date.

Proposed Rule 14a-11 establishes a procedure, patterned after the procedure for shareholder proposals under Rule 14a-8, under which a company can challenge the eligibility of a nominating shareholder, shareholder group or any shareholder nominees. If the company decides to exclude a shareholder nominee, it must notify the nominating shareholder or group of this intention within 14 calendar days after receiving the Schedule 14N and provide an explanation of its basis for determining that it may exclude the nominee. The nominating shareholder or group then has 14 calendar days to respond and correct any eligibility or procedural deficiencies identified by the company, but it cannot change any nominee or alter the composition of the shareholder group in order to cure a defect. If the company still determines that it can exclude a shareholder nominee, it must provide notice of the basis for this determination to the SEC and provide a copy of that submission to the nominating shareholder or group. The nominating shareholder or group will then have 14 days to provide to the SEC and the company a response to the company's notice, and thereafter the SEC staff will provide a statement of its views in the form of a no-action letter. At least 30 days prior to the time it files its definitive proxy statement with the SEC, the company is required to notify the nominating shareholder or group as to whether it intends to include or exclude the nominee from its proxy statement.

**Passive Investors Can Remain Passive and Unaffiliated**

The SEC's proposed proxy access rules provide good news for passive investors who report their beneficial ownership on Schedule 13G rather than Schedule 13D. Although the nomination of directors has traditionally been viewed as seeking to influence control of the company (resulting in a loss of Schedule 13G eligibility for most 13G filers), the SEC is proposing to amend the Schedule 13G eligibility rules to carve out any activities undertaken solely in connection with a nomination under Rule 14a-11.

In addition, the proposed proxy access rules provide a safe harbor that will protect nominating shareholders and groups from being deemed "affiliates" of the company, a status that might impose trading restrictions on the nominating shareholder or group. An instruction to proposed Rule 14a-11 provides that a nominating shareholder or group will not be deemed to be an "affiliate" of the company under the Securities Act of 1933 or the Exchange Act solely as a result of nominating a director or soliciting for the election of the director nominee pursuant to Rule 14a-11. Moreover, if the nominee is elected and if the nominating shareholder or group does not have an agreement or relationship with that director (other than in connection with his or her nomination and election), the nominating shareholder or group will not be deemed to be an "affiliate" solely by virtue of having nominated that director.

**Looking Forward**

It is widely believed that the SEC will seek to adopt final proxy access rules in time for the 2010 proxy season. This timing, however, is uncertain given the large number of questions on which the SEC is seeking comment and the high volume of comments expected to be received on this controversial proposal.

Shareholders who hope to avail themselves of the proposed proxy access rules for the 2010 proxy season will have to plan ahead because there will be little time to submit notices on Schedule 14N after the final rules are adopted. Deadlines for some companies will fall in 2009 rather than in the first months of 2010, and many other companies will be revisiting their advance notification bylaw provisions in light of the proposed rules and may advance their deadlines in response to them.

* * * * * * * * * * * * * * *

If you have any questions regarding these proposed SEC rules or shareholder activism, please contact Michael A. Schwartz (212-728-8267, mschwartz@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

June 30, 2009