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SEC Walks Away from Part of New Proxy Access, Faces Imminent Deadline on Remainder

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Earlier this week, the Securities and Exchange Commission stated that it will not seek further appeal after the DC Circuit struck down new Rule 14a-11, which would have permitted universal direct proxy access. However, the agency hinted that it may allow amendments to Rule 14a-8, which would permit shareholder proposals on proxy access, to become effective in the near future. The new proxy access Rule 14a-11 would have permitted shareholders directly to nominate directors to a company's board for election, bypassing the board and its nomination committee.

The litigation in the DC Circuit involved only Rule 14a-11. It did not involve amendments to Rule 14a-8, which permit shareholders to submit proxy access proposals on a company-by-company basis, subject to state law. As of now, only Delaware has amended its laws to explicitly permit such proposals.

The SEC had stayed both rules when the litigation was filed in the DC Circuit, but the stay of the Rule 14a-8 amendments will expire when the court's verdict is finalized. If the agency does not renew the stay, the Rule 14a-8 amendments will become effective, and may become operative for some companies for the 2012 proxy season.

It is unclear what action the agency will take. If the agency decides to seek to re-propose Rule 14a-11 later this year, with modifications designed to address the court's concerns, it seems likely that it will renew the stay on Rule 14a-8 and maintain the status quo. If the Commission were to permit Rule 14a-8 to take effect, it is possible that some companies would adopt mechanisms that are inconsistent with any new universal proxy access that it may later adopt. If the Commission does not plan to re-propose Rule 14a-11, it may allow the Rule 14a-8 amendments to take effect.

What were the amendments to Rule 14a-8?

The amendments to Rule 14a-8(i)(8) narrowed a company's ability to exclude shareholder proposals relating to election of directors. The revised Rule14a-8(i)(8) would provide shareholders with a mechanism for including in company proxy materials proposals that would address the inclusion of shareholder director nominees in the company’s proxy materials.

The old Rule 14a-8(i)(8) allowed exclusion of a shareholder proposal to set up a proxy access mechanism or to nominate a particular person for a board seat. The revised rule, if implemented, would permit proposals to set up a proxy access mechanism, subject to the requirements of state law, pursuant to which shareholders could force a company to include their nominees on the company's proxy card.

Why were the amendments to Rule 14a-8(i)(8) stayed?

The SEC voluntarily stayed the amendments to Rule 14a-8 in 2010 during litigation over the proposed universal shareholder access Rule 14a-11.[1] The SEC explained that the amendments to Rule 14a-8 were "intertwined" with Rule 14a-11.

Rule 14a-11 would have required that a public company include in its proxy materials candidates for election to the board who had been nominated by shareholders who continuously owned at least three percent of the voting power of the company's securities for three consecutive years at the time of the nomination.

On July 22, 2011, the DC Circuit vacated Rule 14a-11, holding that the SEC acted arbitrarily and capriciously in violation of the Administrative Procedure Act when adopting these federal universal proxy access rules.[2] The court agreed with the petitioners' argument that the Commission neglected both to quantify the costs companies would incur in opposing shareholder nominees, as well as to substantiate the rule's predicted benefits. The court also ruled that the Commission failed to appropriately consider the consequences of unions and state pension funds using the rule.[3]

What will happen with Rule 14a-11?

In the aftermath of the DC Circuit decision to vacate Rule 14a-11, Meredith Cross, the Director of the SEC's Division of Corporate Finance, stated that the SEC was considering its options going forward. She also highlighted that the amendments to Rule 14a-8 were unaffected and implied that the stay on these amendments might be lifted.[4]

Now, SEC Chairman Mary Schapiro has made it clear that the Commission won't appeal the federal court decision throwing out Rule 14a-11, but suggested the agency might rewrite the regulation after staff consideration of the outcome of the litigation.[5] Specifically, Chairman Schapiro has indicated that she remains committed to making it easier for shareholders to nominate candidates for boards, and that the staff will review the court decision as well as interested party comments. That may mean allowing the 14a-8 amendments to become effective in the near future, or it may mean re-proposing Rule 14a-11.

What impact will 14a-8(i)(8) have on the 2012 proxy season?

Rule 14a-8(e)(2) requires shareholder proposals to be received not less than 120 days before the anniversary date of the mailing of the previous year's proxy statement (or within a reasonable time before a company begins printing proxy materials if the meeting date has been moved by more than 30 days). Depending on the mailing date of last year's proxy materials, shareholders at some companies may still have time to submit proxy access proposals under amended Rule 14a-8 if the stay is not renewed.

Some companies may still take the position that such proposals are not permitted under state law. Delaware, however, has amended its laws to permit proxy access mechanisms. The Delaware legislature adopted Section 112 of the Delaware General Corporation Law, which explicitly authorizes, but does not require, bylaws granting shareholders access to the corporation’s proxy materials to nominate directors. Section 113, which also is enabling, permits a bylaw providing for the corporate reimbursement of shareholders soliciting proxies for the election of directors.

Conclusion

Much depends on the SEC's own decisions with respect to proxy access. Companies, however, should consider the possibility that stockholder proposals relating to proxy access may become a factor as early as the 2012 proxy season.

[1] For Stay of Effect of Commission’s Facilitating Shareholder Director Nominations Rules, Release No. 63031 (Oct. 04, 2010) *available at* http://www.sec.gov/rules/other/2010/33-9149.pdf.

[2] Business Roundtable, et al. v. SEC, No. 10-1305 (D.C. Cir., July 22, 2011) *available at* http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBI 1305-1320103.pdf.

[3] Ibid.

[4] "Statement Regarding Court of Appeals Decision on Proxy Access," by Meredith Cross (Jul. 22, 2011) http://www.sec.gov/news/speech/2011/spch072211mc.htm.

[5] "No Appeal on SEC Proxy Rule" (Sep. 08, 2011) *available at* http://online.wsj.com/article/SB10001424053111904900904576555253963782370.html?r .

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