

Corporate Governance Commentary

Proxy Access Analysis No. 3

July 9, 2009

We welcome you to the first of a series of Proxy Access Bulletins and Analyses jointly published by Latham & Watkins LLP and Georgeson Inc. These publications follow on from prior 2009 publications by each firm dealing with earlier stages in the proxy access debate. By combining thoughtful legal analysis from Latham & Watkins with Georgeson's expertise on trends related to corporate governance, the shareholder voting process and other shareholder matters, we hope to provide you with timely, useful and practical guidance as you navigate the issues created by proxy access.

The Latham & Watkins-Georgeson Proxy Access Bulletins and Analyses are designed to:

- › Facilitate your understanding of the various proposals being made on multiple fronts to enable shareholder proxy access
- › Support your efforts to shape the outcome of these proposals on the legislative and regulatory fronts
- › Assist you in taking concrete action in response to the final rules as a matter of both procedure and best practices as they emerge

Our *Proxy Access Bulletins* will be brief updates on "breaking" events related to proxy access, to be delivered quickly following material new developments. They will be short, fact-specific alerts intended to keep our clients and friends up-to-date on a real time basis.

Our *Proxy Access Analyses* will focus on in-depth analysis of the relevant legal and practical issues of proxy access as they develop and will suggest concrete actions we think companies should consider in response to proxy access developments.

For additional resources regarding this topic, please click [here](#) and [here](#).

Some Suggestions for Public Company Responses to the Pending SEC Proxy Access Rule Proposal

Now that the SEC has issued its proposed proxy access rules and asked for comments by August 17, a critical issue for public companies is what do to in response to this SEC initiative and when. In this Proxy Access Analysis, we provide suggestions for how general counsel and corporate secretaries may begin to educate their management and boards on the issues presented by the proposed rules, evaluate the alternatives for commenting on the proposed rules and plan a course of action for their companies if proxy access is adopted for the 2010 proxy season.

There is a limited amount of time for dealing with proxy access, given the August 17 deadline for SEC comments and the SEC's apparent intent to promulgate final proxy access rules by the end of November so that they can be effective for the 2010 proxy season. As a result, general counsel and corporate secretaries should be reviewing their board and governance committee meeting schedules now to be sure that there is ample time to educate their management and boards and to take any actions deemed appropriate by their boards, with sufficient flexibility to accommodate the SEC's proxy access rule-making calendar as it develops.

Educate Your Management and Your Board

First, general counsel and corporate secretaries should ensure that their management and boards understand the proposed SEC proxy access rules and, if their companies are incorporated in Delaware, the new Delaware statutory authorizations for proxy access bylaws that become effective on August 1, 2009.

- › General counsel and corporate secretaries may want to consider using prior Latham & Watkins-Georgeson Corporate Governance Commentaries on Proxy Access to begin educating their management and board. See our [Proxy Access Bulletins and Analyses](#) and [related commentaries by Georgeson](#). The education should cover not only the basic concept of proxy access, but also its practical implications in terms of potential proxy contests arising

from proxy access nominations, as well as internal board governance issues that would be raised by a successful proxy access candidacy.

- › Appropriate management and board education, in our view, should also include an understanding of the range of choices that boards will face:
 - › First, in deciding whether or not to submit an SEC comment letter (as detailed in the next section of this Proxy Access Analysis), and
 - › Second, in dealing with proxy access if it becomes a reality in the fall of 2009, either as a prescriptive rule along the lines proposed by the SEC or as a “free writing” opportunity for shareholder proposals (as described in the last section of this Proxy Access Analysis).

Consider Submitting a Company Comment Letter to, or Requesting a Meeting with, the SEC

In educating management and their boards, general counsel and corporate secretaries may want to help their boards (or governance committees, as appropriate) determine whether their companies should submit a comment letter to the SEC or should have company representatives meet directly with SEC Commissioners or staff to provide their companies’ input on the proposed proxy access rules.

- › Although there are cynics who believe that the SEC will pay only lip service to corporate comments on proxy access, the SEC Commissioners and staff have been outspoken about their desire to hear from all parties who would be affected by the proposed rules. In addition, as illustrated by the 500+ questions contained in the SEC release on proxy access (and the ensuing obligation under governing administrative law to take the responses into account in any final rule-making), the SEC appears sincere in this desire.
- › Activist shareholders and third parties who have long supported proxy access can be expected to show strong support for the proposed proxy access rules, both in comment letters and in meetings at the SEC. In light of the strong support these constituencies will voice for proxy access and the prescriptive and seemingly exclusive nature of the SEC’s proposal for proxy access, the corporate community should not shy away from providing comments, with the hope that, at the very least, a more balanced final rule will result.

For the companies considering whether to submit a comment letter, we offer the following considerations:

- › Individual company comment letters can make a strong impression on the SEC and may serve as an effective counterbalance to the comment letters that we expect will be submitted by corporate governance activists. For this reason, and because of the importance of the proxy access issues, we believe a large number of companies will choose to comment on the rule proposals.
- › For the companies that have the time, resources and willingness to submit SEC comments, we strongly recommend that they write comment letters that are thoughtful, well-reasoned and as specific as possible. To be effective, a comment letter should provide reasons to back up a company’s comments and, where appropriate and available, supporting facts and figures – even if anecdotal and particular to the company submitting the comments.
- › However, company management and boards should be aware that proxy access has become a highly politicized governance issue, which has public relations and investor relations implications beyond those of many other corporate governance issues and the typical SEC rule-making process. Not only is it the subject of proposed legislation in the U.S. Congress, it is a high-priority issue for corporate governance activists and is likely to be embraced by the proxy advisory firms such as RiskMetrics. Because comment letters are posted by the SEC on its website, some boards, although opposed to proxy access, may choose to refrain from taking a public stance at this stage in the process given this highly charged environment.
- › Companies may also be deterred by the time and resources that are required to produce a thoughtful comment letter in a short period of time (the deadline for comments is August 17).
- › Finally, we note that as an alternative or supplement to submitting a comment letter, companies have the option to request meetings with SEC Commissioners or staff members of the SEC Division of Corporation Finance to explain their specific concerns about the SEC’s proposed proxy access rules.
 - › Meetings of this sort present an opportunity for a company to make its views directly known to the SEC on an individual basis. The SEC Commissioner(s) or staff member(s) will record the meeting in the form of a memorandum, which is typically rather brief and states the name of the people with whom they met and the

general topics discussed. This memorandum would become public as part of the SEC's rule-making file. Some companies may be more comfortable explaining their views in this setting, as opposed to a full-blown comment letter.

- › If your company is interested in pursuing this option, please contact any of the Georgeson or Latham & Watkins representatives listed at the end of this Proxy Access Analysis or the representatives from either firm with whom you normally consult.

Companies that choose to comment, either in writing or at an in-person meeting, may consider commenting on the following issues, among others:

- › Whether the SEC has statutory authority to adopt a prescriptive proxy access rule,
- › Whether the SEC has articulated a rational basis for its rule-making, as required by administrative law,
- › Whether the principles of federalism are inappropriately infringed upon by the SEC rule making, particularly in light of Delaware's adoption of a statute specifically enabling companies to adopt proxy access bylaws and the parallel modification being made in the Model Business Corporation Act,
- › Whether, in light of the many corporate governance reforms imposed on companies over the past several years, as well as those voluntarily adopted by many companies, it is necessary or appropriate to impose proxy access for all public companies,
- › Whether shareholder democracy is appropriately served by a prescriptive rule that is not subject to any shareholder vote, either to adopt the SEC's proxy access regime or to opt out of the SEC's proxy access regime in favor of a modified form of proxy access or, indeed, no proxy access at all, and
- › Whether the basic parameters for proxy access eligibility (such as the sliding scale for the amount of securities that must be held and the one-year holding period) are appropriate and supported by the available data.

In addition, after discussing proxy access in broad strokes, companies should also consider delving into the specific technical, but critical, issues that the proposed SEC proxy rules (if adopted) either do not address or address incompletely. If companies choose to so comment, we recommend that wherever possible, companies use their unique circumstances to back up their concerns.

- › For example, if controlling shareholder(s) can elect all directors, the company may want to argue that it is not appropriate to be subject to proxy access because the "controlling shareholder(s)" will not vote for access candidates and the process will be costly and futile.
- › Similarly, if a company has two classes of directors, each elected by a different class of stock, it may want to contend that the proposed rule should apply only to the class of stock held by the largest number of public shareholders.

These type of issues are often referred to as "workability." Other workability issues include:

- › Is it appropriate for all access slots to be filled by a single shareholder or shareholder group?
- › If more directors are nominated through access than available slots, should the earliest nominations prevail or would it be better to allow for later, but still timely, nominations by larger shareholders or shareholder groups?
- › If a director is elected through proxy access, should he or she lose this status as an access director if she is re-nominated for a second term? If so, doesn't this create a perverse incentive not to re-nominate access directors?
- › Should the fact that a company has a staggered board affect the number of directors that can be nominated at any one annual meeting?
- › Should a nominating shareholder or shareholder group be required to maintain the requisite ownership until the annual meeting? Would a longer period be appropriate?
- › Shouldn't the minimum share holding requirement for access deal with derivatives and so-called "empty voting" issues and, if so, how?
- › How should proxy access be integrated with advance notice bylaws, given that the proposed proxy access process needs significant time for resolution of disputes concerning nomination eligibility, which time is not needed in a traditional proxy election contest and therefore is not provided in typical advance notice bylaws?
- › Should the SEC rules permit a proxy access "contest" simultaneously with a traditional proxy election contest and, if so, should the nominating shareholders be allowed to solicit for the other insurgent slate and vice-versa?
- › Should the nominee be required to be independent from the nominating shareholder? If not, should the rule otherwise provide for potential problems arising from election of "special interest" directors?

- › Should companies be able to require proxy access directors to maintain strict confidentiality of all non-public information received in their capacity as directors, including confidentiality from their nominating shareholders? If not, how will the lack of confidentiality affect board room decision-making and dynamics?
- › Should companies impose non-discriminatory “qualification” standards on directors nominated by proxy access, such as age, restrictions on the number of board and board committee positions at other companies (so-called “over-boarding”), or citizenship for purposes of appropriate regulated industries?
- › Can hedge funds and other activist investors with “control agendas” utilize the access procedure? What if they disclaim control intent at the time of the nomination and later “change their mind”?
- › Proxy access will require a so-called “universal” proxy card listing all nominees for director, which will be more than the number of open seats on the board. This form of proxy has never before been used by U.S. public companies. How should voting errors, such as over-votes and under-votes, be dealt with? Are there other practical problems posed by a universal ballot?
- › Should shareholders who have nominated proxy access candidates and the board be permitted to solicit for their “candidates” using traditional proxies that don’t list opposition candidates?
- › What rules should govern proxies issued by traditional dissident slates if the SEC rules permit simultaneous proxy access election contests and traditional proxy election contests?
- › Is it appropriate for the SEC to have “primary” jurisdiction to resolve disputes concerning eligibility of nominations for inclusion in the proxy material through an informal staff no-action letter process? What recourse will the parties have if the staff doesn’t issue a no-action response in time for printing and mailing of the proxy material? Should the SEC staff be required to explain its decisions as a court would? Would the appeal process to the full Commission be sufficiently streamlined to produce an answer prior to the printing and distribution of the proxy material?
- › What are the implications of amendments to a nominating shareholder’s SEC filing prior to the annual meeting? If, for example, the nominating shareholder sells its stock days, weeks or months after its filing, are or should there be any the consequences? What if, between the time a proxy access nominee is included in the proxy material and the meeting date, it is determined that the nomination did not, in fact, comply with the SEC rules? Can the company issue new proxy cards omitting the name of that nominee? Can it disregard votes for the nominee cast on the original proxy card?
- › Should there be sanctions for proxy access directors and their nominating shareholders if it is determined after the annual meeting that the nomination did not meet all of the requirements (for example, a hidden control intent)?
- › Is it appropriate to allow shareholders to use the Rule 14a-8 process to propose more shareholder friendly proxy access rules? If so, why shouldn’t shareholders also be permitted to adopt more restrictive proxy access bylaws?

Other Appropriate Actions in Anticipation of Proxy Access

Several commentators have suggested that public companies should consider revising their bylaws in anticipation of the SEC’s adoption of a proxy access regime in differing ways.

- › One school of thought is that public companies should act preemptively and adopt proxy access bylaws in advance of the SEC’s final rulemaking. The reasoning underlying this approach is that if enough companies do so, it will show that (1) private ordering can and will adequately address proxy access over time and a prescriptive SEC rule is unnecessary, (2) as in the case of the relatively rapid shift by many public companies from plurality to majority voting in uncontested director elections, such voluntary governance changes can be rapidly and widely effected, and (3) a one-size-fits-all prescriptive rule is neither feasible nor desirable because companies will adopt differing preemptive proxy access bylaws to fit their specific circumstances.
- › Other commentators have recommended far more modest bylaw amendments to deal with the proposed SEC rule provision that a company’s advance notice bylaws will control in determining the latest date by which nominations of proxy access candidates must be received by the company.
 - › The proposed rule establishes a minimum notice period of 120 days before the date of mailing the prior year’s proxy materials, or approximately 150-160 days prior to the annual meeting, for companies without advance notice bylaws. Most advance-notice bylaws, however, require a minimum notice of 60 or, at most, 90 days prior to the annual meeting. This latter time frame is intended for director nominations by shareholders who will disseminate their own proxy material and is far too short to accommodate the SEC’s proposed access regime and dispute resolution process. Accordingly, commentators have suggested that companies amend their existing advance notice bylaws to make clear that they are not applicable to proxy access nominations or to require advance notice under the same time frame as the proposed proxy access rule.

- › On balance, however, we recommend against adoption of either a full-fledged proxy access bylaw or a revised advance notice bylaw during the pendency of the SEC rulemaking process. Our primary reason for this recommendation is that until it is clear how the SEC proxy access rules will be finalized, management and boards may waste time and expense on a bylaw or bylaw revision that may be preempted or may require significant or complete revisions as a result of subsequent Commission action within a matter of a few months.

In the event the SEC ultimately approves a prescriptive proxy access rule (along the lines of proposed Rule 14a-11), a company will need to quickly determine whether there is any room for a private ordering by the company and/or its shareholders, either to supplement the prescriptive rule or to establish an alternative proxy access regime. For example, a final SEC rule might include:

- › A procedure by which shareholders, either with or without a board recommendation, could vote at a shareholders meeting to opt out of the SEC regime in favor of a different proxy access regime or even no proxy access at all.
- › Supplemental bylaw provisions dealing, for example, with:
 - › Non-discriminatory director eligibility standards, such as minimum and maximum age for board membership, limits on “over-boarding” and regulatory regime requirements applicable to a company that are premised on U.S. citizenship, regulatory licensing or the like;
 - › Non-discriminatory governance and confidentiality policies, such as maintaining confidentiality of material non-public information and with respect to board deliberations (in both cases, this could prevent proxy access nominees from sharing such information with their respective nominating shareholders);
 - › Unusual voting structures, such as two classes of voting common stock or two classes of directors elected by different classes of common stock;
 - › Board or nominating committee endorsement of a proxy access nominee as a member of the board’s slate;
 - › Withdrawal of a proxy access nominee and replacement by other proxy access nominees; and
 - › Changes in circumstances after the company’s proxy material is mailed, such as disqualification of the proxy access nominee.

Similarly, if the SEC were to amend Rule 14a-8 to permit proxy access shareholder proposals for the 2010 proxy season, but defer action on a prescriptive proxy access rule (i.e., proposed Rule 14a-11), companies would be faced with difficult decisions in the same very limited time periods that they face with other Rule 14a-8 proposals. For example,

- › Although a company might adopt a full-fledged proxy access bylaw as a basis for seeking exclusion of any shareholder proxy access proposal under the “substantial implementation” standard of SEC Rule 14a-8, we note the SEC staff has historically granted no action requests under this exclusion only rarely.
- › We think it would be better, instead, for the board to propose a proxy access bylaw for adoption by shareholders at an annual meeting, so as to have a basis for excluding a shareholder proposal under Rule 14a-8 as “directly conflicting” with the board’s proposal.
- › Another issue is whether a company should be preemptive in implementing one of these strategies before receipt of a shareholder access proposal or whether it should defer action until after it receives a shareholder access proposal, figuring it can always pursue (perhaps through engagement and negotiation with the shareholder proponent and possibly other significant shareholders) one of the above strategies after a shareholder proposal is received.

If you have any questions regarding this Commentary, please contact the Georgeson Inc. representatives or Latham & Watkins LLP representatives listed below or the Latham attorney with whom you normally consult.

Latham & Watkins LLP Representatives

Adel Aslani-Far

Barry Bryer

Alex Cohen

Bradley Faris

Mark Gerstein

Scott Herlihy

Scott Hodgkins

Peter Kerman

Robert Koenig

Richard Meller

Brian Miller

Chuck Nathan

John Newell

Raluca Papadima

David Schwartzbaum

Constantine Skarvelis

Steven Stokdyk

Paul Tosetti

Joel Trotter

Georgeson Inc. Representatives

David S. Drake

President

+1.212.440.9861

New York

Rhonda L. Brauer

**Senior Managing Director -
Corporate Governance**

+1.212.805.7168

New York

Rachel L. Posner

**Senior Managing Director and
General Counsel**

+1.212.440.9921

New York

Rajeev Kumar

**Senior Managing Director -
Research**

+1.212.440.9812

New York

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