

SEC Urged to Defer Adopting Proxy Access Rules

A broad cross section of commenters is encouraging the Securities and Exchange Commission (the “SEC”) to take a cautious approach with its latest proposal to allow shareholders to solicit votes for their director candidates through corporate proxy statements.¹

The SEC received over 520 comment letters to date recommending a host of modifications to its proposal for uniform mandatory proxy access. Some commenters, including members of the investor community, have expressed concerns about the desirability of any uniform mandatory proxy access rule. Significant investor constituencies have also expressed concern about a possible compromise being advocated by companies and their representatives: deferring adoption of a uniform mandatory proxy access rule and instead allowing shareholders to propose bylaw amendments permitting proxy access through the existing shareholder proposal process. That compromise does have institutional investor support, however, with one leading investor recommending raising the ownership threshold for shareholder proxy access bylaw amendments to 5%.

In 2003 and 2007, the SEC proposed different rules to give shareholders greater access to a company’s annual proxy materials to nominate candidates for election as directors. In response to those rule proposals and investor concerns, states and corporations have taken steps to allow for proxy access and expanded shareholder influence in director elections. In addition to greater adoption of majority voting standards, states such as Delaware have recently adopted laws specifically permitting proxy access and proxy solicitation expense reimbursement bylaws. In response to a perceived need for greater director accountability arising out of the recent financial crisis, the SEC released its latest proposal that would mandate a uniform federal access right to a company’s proxy materials for shareholders who meet minimum holding period and ownership threshold criteria.

We reviewed forty-one of the comment letters submitted to the SEC in response to the proposed rule (the “**Representative Comment Letters**”) and have summarized the primary issues and concerns raised by key constituencies advocating for corporate, board, and investor interests.² Our choice of the Representative Comment Letters was based on a number of factors such as the interest groups they represent, whether they traditionally have been active in the corporate governance field, and whether they represent typical points of view for their type of organization. For a chart summarizing the views presented in the Representative Comment Letters please [click here](#). The chart is organized by governance constituency, starting with investor advocates and ending with corporate interests.

Consensus is to Allow Shareholder Proposed Bylaw Amendments in Corporate Proxy Materials; Some Investors Recommend Higher Eligibility Criteria

The Representative Comment Letters reflect broad acceptance, even among the business community, of an amendment to Rule 14a-8 to allow shareholders to propose proxy access bylaws in a company’s proxy materials. Adoption of the Rule 14a-8 amendment only would allow time to test whether corporate and shareholder action is sufficient to respond to investor concerns regarding greater proxy access. Even some activist shareholders, such as

¹ For the full text of the proposed rule, see “*Facilitating Shareholder Director Nominations*,” Release No. 33-9046, dated June 10, 2009 (proposing a new 14a-11 proxy access rule and amendments to rule 14a-8), available at: <http://www.sec.gov/rules/proposed/2009/33-9046.pdf>.

² The Representative Comment Letters are available at: <http://www.sec.gov/comments/s7-10-09/s71009.shtml>.

the United Brotherhood of Carpenters and Joiners of America, have urged adoption of the amendment to Rule 14a-8 instead of implementation of a uniform mandatory proxy access rule.

While there is broad acceptance of an amendment to Rule 14a-8, a key institutional investor, Capital Research and Management, echoed the concerns of a number of issuers and recommended raising the minimum ownership threshold under Rule 14a-8 for those shareholders who wish to propose a proxy access bylaw amendment.³ Capital Research and Management argues that increasing the eligibility requirement is necessary to avoid the pitfalls of allowing short-term investors with an adverse motive to clog a company's proxy materials with nuisance proposals. In its comment letter, Capital Research and Management suggests a 5% ownership threshold to "align the interests of shareholder proponents with those of long-term shareholders."

Support for Cautious Approach on Proxy Access

A number of key institutional investors, notably Barclays Global Investors, Capital Research and Management, and ValueAct Capital, have expressed concerns similar to business groups that adopting the proposed rule without a full understanding of the short-term and long-term impact on the corporate and investor community may cause a rush of short-term-focused, opportunistic nominations that will impede board activity and have an adverse effect on the performance of the companies targeted. Some traditional shareholder activists, including the United Brotherhood of Carpenters and Joiners of America, have recommended that the SEC postpone adopting a uniform mandatory proxy access rule until the corporate community and shareholders can respond to investor demands for greater proxy access. Other commenters, such as the Altman Group, a Group of Former SEC Senior Staff and a Group of Seven Leading Corporate Law Firms, have suggested that deferring the proposed proxy access rule will allow it to be more fully developed and give companies and shareholders time to evaluate their current governance structure and adopt more refined and tailored proxy access rules.

Several Representative Comment Letters have pointed out that, as a practical matter, it will be difficult or impossible to implement any newly adopted proxy access rules in time for the 2010 proxy season. In particular, Broadridge, a leading proxy services firm, has stated it would take at least five months from publication of a final rule to establish the technology and resources needed to accommodate the proposed rule. Moreover, a Group of Former SEC Senior Staff claim that the SEC does not have the manpower or resources in place to handle the number of issues and inquiries that will arise upon implementation. In addition, the Representative Comment Letters suggest that the SEC could face a number of legal challenges.

Substantial Issues Remain Before Any Proxy Access Rule Could Be Adopted

Beyond a general consensus to adopt an amendment to Rule 14a-8, the Representative Comment Letters reflect a large divide among key constituencies, some of whom advocate for nothing more than the proposed amendment to Rule 14a-8, and others who argue for a prescriptive proxy access rule. While there are supporters for implementing a uniform mandatory proxy access rule, almost none of the Representative Comment Letters have advocated for full adoption of the proposed rule without modification.

The Representative Comment Letters contain a broad array of recommendations regarding changes to the proxy access proposal, with the following items at the forefront of the debate:

- *Opt-out.* If a uniform mandatory proxy access rule is adopted, a number of the constituencies have recommended that an opt-out feature (i.e., private ordering) be included to allow companies and

³ Eligibility under Rule 14a-8 currently requires ownership of at least \$2,000 or 1% of a company's securities entitled to vote on the proposal.

shareholders to decide whether the uniform proxy access rule should apply to them at all or on different terms. Professor Grundfest from Stanford University has argued that the proposed rule violates the Administrative Procedure Act, but suggested that an opt-in mechanism, whereby a majority of shareholders may determine whether proxy access rules should be adopted, solved this legality issue.

- *Ownership Threshold.* A general theme among the Representative Comment Letters, including among institutional investors such as the Council of Institutional Investors, T. Rowe Price and Barclays Global Investors, was to limit proxy access to larger long-term investors. Although, the Representative Comment Letters proposed ownership thresholds ranging from 1% to 15% of a company's outstanding securities, it is noteworthy that ValueAct Capital, Capital Research and Management and Barclays Global Investors recommend a high threshold (e.g., 10% or 15% in some cases). Overall, the majority of key constituencies agree on a minimum 5% threshold (up to 10% for groups), regardless of a company's size, with the ability to aggregate or group shares as the proposal allows.
- *Holding Period.* A number of institutional investors and shareholder activists, such as the Council of Institutional Investors, Ohio Public Employees Retirement Systems, TIAA CREF and T. Rowe Price support a minimum holding period of two years to be eligible for access to a company's proxy materials. In addition, a number of Representative Comment Letters, notably CalPERS, the American Federation of State, County and Municipal Employees and the Council of Institutional Investors, have asked the SEC to provide greater clarity on the ownership requirements during the applicable holding period (e.g. such as clearly defining "beneficial ownership"). Some institutional investors, such as T. Rowe Price and ValueAct Capital, have recommended that proxy access should apply only to shareholders who hold net long positions in a company, and thus, the disclosures and prohibitions should be drafted to support such a requirement. A Group of Corporate Secretaries and Governance Professionals (representing the views of twenty-seven large corporations) and the Business Roundtable have also recommended that nominating shareholders be required to retain ownership over their shares throughout the election and, if their nominees are elected, the period during which their nominee is in office.
- *Number of Nominees.* The Representative Comment Letters indicate a divide over the number of shareholder nominees that should be permitted. The general consensus appears to be for 15%-25% of a company's board with a minimum of at least one director. However, certain corporate and board advocates suggest that only a maximum of one shareholder nominee should be allowed, while the Council for Institutional Investors and some shareholder activists have suggested up to 50% of a company's board, but at the very least two directors should be allowed in a company's proxy materials.
- *Nominee Independence and Disclosure.* A majority of the Representative Comment Letters agree that full disclosure by the nominating shareholder and the shareholder nominee of (i) the number of shares owned, (ii) the economic interests held in a company, and (iii) limitations on independence from a company and other interested parties should be required. In addition, a number of Representative Comment Letters representing business interests, have argued that the shareholder nominee should be independent from the shareholder nominator. None of the Representative Comment Letters representing shareholder interests advocated for a similar view, however a number of investors including CalPERS and the Council of Institutional Investors would support the requirement that all relationships between the nominee and the nominators be fully disclosed. Some Representative Comment Letters, such as those from Ohio Public Employees Retirement Systems, the RiskMetrics Group and business groups have also recommended that shareholder nominees meet the same guidelines and independence requirements as applicable to the board's nominees.
- *First-to-File.* The Representative Comment Letters are unanimous in their rejection of the SEC's proposed first-to-file concept. Almost all commenters agree that shareholders with the largest economic interest in the company should have first priority in placing their nominee in a company's proxy materials, while a few Representative Comment Letters have also recommended that those shareholders who have held their shares the longest be given priority.

Conclusion

Although the commenters generally support granting shareholders the ability to propose a proxy access bylaw amendment through a company's proxy materials, the Representative Comment Letters raise a number of fundamental issues with the mandatory uniform proxy access rule proposed by the SEC. A clear implication is that the SEC ought to take a cautious approach with regard to adopting and implementing a proxy access rule. Adoption of the proposed rule in its current form, or a rushed refinement of the proposed rule, likely will have significant unintended consequences. The Representative Comment Letters suggest that the SEC should defer adopting any proxy access rule so as to allow corporations and their shareholders to respond to concerns raised by the SEC and investors for greater proxy access.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact

Phillip R. Mills	212 450 4618	phillip.mills@davispolk.com
Francis S. Currie	650 752 2002	frank.currie@davispolk.com
Linda Chatman Thomsen	202 962 7125	linda.thomsen@davispolk.com
Ning Chiu	212 450 4908	ning.chiu@davispolk.com
Robert L.D. Colby	202 962 7121	robert.colby@davispolk.com

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