

Please feel free to contact us if we can provide further information on these matters.

## SEC Proposes New Rule to Expand Shareholder Access to Corporate Proxies

May 20, 2009

**John W. White**  
212-474-1732  
jwhite@cravath.com

**Richard Hall**  
212-474-1293  
rhall@cravath.com

At an open meeting held today, the Securities and Exchange Commission (“SEC”) voted, 3 to 2, to issue a proposed rule, which, if adopted, would (i) provide a federal “proxy access” procedure for shareholders of U.S. public companies subject to the SEC’s proxy rules to include shareholder-nominated director candidates in company proxy materials at company expense and, in addition, (ii) require the inclusion in company proxy materials of shareholder by-law proposals creating proxy access procedures less restrictive than the federally mandated procedure. The proposal issued today follows failed attempts in 2003 and 2007 to adopt rules allowing for proxy access.

### BACKGROUND

Proxy access, and the role of the federal securities laws in providing it, have been the subject of considerable debate in recent years, as shareholders, and increasingly Congressional leaders, have rallied to the cause. At the same time, the federalization of corporate law more generally, and proxy access in particular, have been met with steady and reasoned opposition. Proponents of proxy access argue that the current system deprives shareholders of meaningful access to the nomination and election process for board members. If shareholders are dissatisfied with a company’s directors, under the current legal framework they must undertake a costly contest, including funding and distributing their own competing proxy materials, in order to put their nominees before other shareholders for a vote. Opponents believe that proxy access is likely to create perennial proxy contests and undue focus by boards on short-term goals, result in the election of special interest directors, and discourage more qualified candidates from seeking participation on corporate boards. In addition, opponents argue that a federal “one size fits all” proxy access rule treads too far into the traditional province of states to regulate corporate law and governance, as stated by the two Republican SEC Commissioners, Kathleen Casey and Troy Paredes, in voting against the proposal at today’s meeting.

SEC Chairman Mary Schapiro has placed proxy access at the top of her agenda since taking office earlier this year. The two Democratic SEC Commissioners, Elisse Walter and Luis Aguilar, both of whom voted for today’s proposal, have publicly expressed their strong support for SEC rulemaking that would mandate proxy access. Other recent developments in this area include Delaware legislation, coming into effect on August 1, 2009, which will expressly authorize, but not require, the adoption of by-laws providing for proxy access. Rather than prescribe the terms of access, such as minimum levels and duration of ownership, Delaware’s new legislative framework leaves such questions to be answered on a company-specific basis through private ordering.

Proxy access has also become the subject of proposed federal legislation. On May 19, 2009, Senator Charles Schumer (D-NY) introduced the Shareholder Bill of Rights Act of 2009. The bill states that the SEC has authority to establish rules on proxy access, which industry groups reportedly may challenge as being a matter of state law. The bill would also require the SEC to establish rules on proxy access according to set parameters—shareholders or shareholder groups would have to have beneficially owned at least 1% of a company’s voting securities for at least a two-year period preceding the next annual meeting. The relationship between this proposed bill and the proposed SEC proxy access rulemaking is as yet unclear.

### THE PROPOSAL

The proposing release has not yet been made publicly available but should be posted soon on the SEC’s website at [www.sec.gov](http://www.sec.gov). The SEC staff’s opening statement describing the proposed rule is posted at <http://www.sec.gov/news/speech/2009/spch052009lb.htm>. The following summary of the proposed rule is prepared based on discussion at the open meeting on May 20, 2009.

**“I believe that the most effective means of providing accountability—in a way that is both cost effective and timely—is to ensure that shareholders have a meaningful opportunity to effectuate the rights that they already have under state law to nominate directors.”** — SEC Chairman Mary Schapiro, in a statement at the Open Meeting on Facilitating Shareholder Director Nominations on May 20, 2009

There are two principal components to the SEC's proposed proxy access rule. The first component would create, through new Rule 14a-11, a federal rule mandating direct proxy access so long as shareholders have the right to nominate directors under state law—which is normally the case—and are not otherwise prohibited by the company's governing documents from nominating a candidate for election as a director. Unlike the 2003 proxy access proposal, this direct proxy access right would not be contingent upon triggering events. The second component of the proposal would provide for the amendment of Rule 14a-8 to allow shareholders to include in the company's proxy materials proposed by-laws creating a proxy access procedure less restrictive than the federally mandated rule.

The key aspects of the federal direct proxy access rules under Rule 14a-11 are as follows:

- **Eligibility to nominate candidates.** The proposal ties eligibility to a tiered approach to ownership of voting securities based on the size of the company. The threshold would be 1% beneficial ownership for large accelerated filers (over \$700 million of unaffiliated float), 3% for accelerated filers (\$75 million to \$700 million of unaffiliated float) and 5% for non-accelerated filers (less than \$75 million of unaffiliated float). In all cases, shareholders or shareholder groups must have held their ownership stake for at least one year prior to the date they notify the company of their intent to nominate director candidates.
- **Number of nominees.** Shareholder proponents could nominate candidates representing 25% of the company's board members, or one candidate, whichever is greater. Where a company receives more shareholder nominees than it is required to include in its proxy materials, the nominees to be included would be those put forward by the nominating shareholder or group that has first provided timely notice.
- **Nominee criteria.** Conditions to a shareholder nominee's eligibility include (i) the nominee's candidacy, or, if elected, board membership, being consistent with applicable law and regulation, (ii) the nominee satisfying the objective independence standards of the national securities exchange on which the company is listed and (iii) the nominating shareholder or group having no agreement with the company regarding the nomination of the nominee.
- **Disclosure.** Nominating shareholders would have to give notice to the company containing certain disclosures and file such notice on a new Schedule 14N. The notice would disclose the size of the nominator's shareholdings, the length of ownership and an intent to continue to hold the subject securities through the date of the meeting. The disclosure would include representations as to eligibility to submit a nomination and a certification that the nominator lacks a control intent. The notice would also include information about the nominating shareholder or group and director nominees similar to that required in proxy contests, which would be included by the company in its proxy materials. Nominating shareholders or groups would be liable for any false or misleading statements provided to the company and included in the company's proxy materials.
- **Timing.** The company would have to receive notice of the nominations at least 120 days prior to the anniversary of the distribution of the prior year's proxy materials. However, if the company's advance notice by-laws provide for different timing requirements for receiving shareholder nominations, the company's requirements would control.
- **Relationship to state law and by-law provisions.** The federal direct access right would be additional to state law proxy access rights, meaning, in effect, that if the eligibility thresholds set by the federal rules are lower than those set expressly by state law or adopted by a company pursuant to enabling state law provisions, the federal rights would control.

In addition, Rule 14a-8(i)(8) would be amended to allow shareholders eligible to submit proposals under Rule 14a-8—those holding at least \$2,000 in market value of the company's voting securities for at least one year as of the date the proposal is submitted—to submit their own by-law proposals on proxy access for inclusion in a company's proxy materials. These proposals could provide for less restrictive access rights than those under the federal proxy access rules. Shareholder by-law proposals could not conflict with the Commission's disclosure rules, including those proposed under Rule 14a-11.

**LOOKING AHEAD**

The proposing release, which will be issued shortly, will be subject to a public comment period. Although the specifics of any final rules are unknown, it seems likely that the SEC will adopt some sort of proxy access rules later this year, with those rules likely to be effective for the next proxy season. And while it seems prudent for public companies to await adoption of any final rules before taking specific responsive steps, including by-law changes, there are a couple of steps companies might consider taking at this time.

As an initial matter, all companies with an interest in this topic should seriously consider commenting on the proposal, either in the company's individual capacity or as a member of a broader trade or industry group. We know from the rulemaking experiences in 2003 and 2007 that this rulemaking will be the subject of intense debate and heavy public input. As Commissioner Walter emphasized at the meeting today, comments will play a critical role as the SEC decides upon the specifics of its final rule.

We would also advise companies to take measured and appropriate steps at this point to reduce the likelihood that they may be targets for shareholder ire, which in turn may reduce the extent to which those companies find themselves the subject of shareholder-initiated proxy contests if proxy access is adopted by the SEC. This should include review of problematic corporate governance, management and executive compensation issues.

*This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.*

**NEW YORK**

Worldwide Plaza  
825 Eighth Avenue  
New York, NY 10019-7475  
212.474.1000

**LONDON**

CityPoint  
One Ropemaker Street  
London EC2Y 9HR  
+44.20.7453.1000

[www.cravath.com](http://www.cravath.com)

**INSERT PAGE DIVIDER**

Please feel free to contact us if we can provide further information on these matters.

**Alan C. Stephenson**  
212-474-1400  
astephenson@cravath.com

**John W. White**  
212-474-1732  
jwhite@cravath.com

**Richard Hall**  
212-474-1293  
rhall@cravath.com

**Alyssa K. Caples**  
212-474-1074  
acaples@cravath.com

## SEC Posts Proxy Access Rulemaking Release—Companies Should Review Bylaws Now

June 25, 2009

On June 10, the SEC released its proposal for the new proxy access rules the SEC voted to propose earlier this spring.<sup>1</sup> If the SEC takes action to adopt the proposed rules, it is possible that the rules could become effective by the end of this year.

The proposal includes a new rule (Rule 14a-11) that would permit shareholders (or groups of shareholders) of U.S. public companies that are subject to the SEC's proxy rules to require the company to include in its proxy materials the shareholders' director nominees. To be eligible to use Rule 14a-11, shareholders must have owned at least a certain percentage of the company's stock for a minimum holding period specified by the rule. The proposal limits the number of directors that shareholders can nominate using Rule 14a-11 to a maximum of one or 25% of the company's board, whichever is greater.

In order for shareholders to have their director nominees included in the company's proxy materials using Rule 14a-11, shareholders must provide the company with advance notice that includes certain disclosures and representations and is filed concurrently with the SEC on a new form (Schedule 14N). In addition, shareholder nominees must meet certain eligibility requirements. The proposed rules establish a procedure for companies to accept or challenge the inclusion of the shareholder nominees in their proxy materials based on compliance with these requirements.

The proposed rules raise two issues relating to companies' advance notice bylaws and existing director qualification requirements. In light of these issues, companies should review their advance notice bylaws and consider whether amendments are appropriate and should be made even before the final rules are adopted by the SEC.

### Advance Notice Requirements

The prior notice a company receives from a nominating shareholder under Rule 14a-11 will be critical to the company's ability to examine thoroughly the shareholder's compliance with the requirements of the rule and, if appropriate, challenge the inclusion of the nominee in the company's proxy materials under the rule's prescribed procedures. Under the proposed rules, in order to rely on Rule 14a-11 a nominating shareholder must provide notice to the company on Schedule 14N by the date specified by the company's advance notice bylaw provision or, where no such provision is in place, no later than 120 calendar days before the date that the company mailed its proxy materials for the prior year's annual meeting.<sup>2</sup> Companies' advance notice bylaws vary, but usually provide for a notice period that is meaningfully shorter than the 120-day period that would otherwise be available under the SEC's proposed rules.

Advance notice bylaws normally come into play in the context of shareholder nominations and proposals that are advanced outside the company's proxy materials. As a result, by mentioning advance notice bylaws the proposed rules have created uncertainty as to proposed Rule 14a-11's intended advance notice period. The SEC may have intended the 120-day period to apply in all cases except when a company has an advance notice bylaw

<sup>1</sup> See SEC Release No. 33-9046 (June 10, 2009), available at <http://www.sec.gov/rules/proposed/2009/33-9046fr.pdf>.

<sup>2</sup> See proposed Rule 14a-18.

that specifically addresses director nominations proposed for inclusion in the company's proxy materials. As written, however, the proposed rules do not draw this distinction.

Companies should consider amending their bylaws to state explicitly that their advance notice provisions do not apply to shareholder nominations to be included in the company's proxy materials. Because the proposed rules could become effective after the 120-day period in the rule has already expired with respect to a company's 2010 annual meeting but before the expiration of the advance notice period in a company's existing bylaws, companies with advance notice bylaw provisions should be prepared to adopt amendments promptly, even before the final rules become available.

As an example, consider a company that mailed last year's proxy materials on March 9, held its annual meeting on April 20 and whose bylaws require advance notice of shareholder nominations no later than 90 days before the anniversary of the prior year's annual meeting. If the new rules were published on December 1, 2009 and become effective on December 31, and are effective for the 2010 proxy season, the deadline set by the company's advance notice bylaw will not yet have passed and the company's shareholders would be able to use Rule 14a-11 to nominate directors for inclusion in the company's proxy materials for the 2010 annual meeting, even though the rule's 120-day period for this company would have expired on November 9, 2009. In this situation, this company may not be able validly to amend its bylaws after November 9 to elect to use the 120-day advance notice period. On the other hand, if this company had amended its advance notice bylaw before November 9, 2009, its shareholders would not be able to satisfy the applicable 120-day advance notice requirement in order to use Rule 14a-11 until the 2011 proxy season.

### **Requirements for Shareholder Nominees**

Some companies' governing documents (*i.e.*, charters and bylaws) include requirements that director candidates must meet in order to stand for election and serve. For example, some bylaws require that each director nominee respond to a company questionnaire and enter into an agreement with the company with respect to certain matters. The text of the proposed Rule 14a-11 provides that a shareholder nominee need not be included in a company's proxy statement if the nominee's candidacy or board membership would violate the company's governing documents.<sup>3</sup> This appears to mean that if the nominee does not meet the requirements set forth in the company's governing documents, Rule 14a-11 would not require the company to include the nominee in the company's proxy materials. On the other hand, the SEC's discussion of Rule 14a-11 in the rulemaking release seems to say that companies are not permitted to prescribe additional requirements that would apply to shareholder nominees, even if those requirements apply to the company's nominees as well. The SEC's description of Rule 14a-11(a)(2) in the release does not refer to the exception relating to the company's governance documents, and actually includes commentary to the effect that a company will not be permitted to exclude shareholder nominees for failure to meet more restrictive requirements set forth in the company's governing documents.<sup>4</sup> If the proposed rule is adopted without further clarification by the SEC, this suggests that different sets of eligibility requirements may apply to nominees for election as directors of the same company, depending solely on the mechanism by which the director was nominated and presented to shareholders for election.

One thing is certain, however: under the SEC's proposal, director eligibility requirements observed by a company but set forth outside of the company's governing documents (*e.g.*, in nominating committee charters or corporate governance policies) would not apply to shareholder nominees submitted under Rule 14a-11. Note that typical eligibility requirements include, among other things, a maximum age for service as a director. Companies should consider amending their bylaws to expressly include their director eligibility requirements or, at the very least, adopting a bylaw providing that director nominees must meet the requirements set forth in the corporate governance guidelines.

*This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.*

#### **New York**

Worldwide Plaza  
825 Eighth Avenue  
New York, NY 10019-7475  
212.474.1000

#### **London**

CityPoint  
One Ropemaker Street  
London EC2Y 9HR  
+44.20.7453.1000

www.cravath.com

<sup>3</sup> See proposed Rule 14a-11(a)(2).

<sup>4</sup> See footnote 152 to SEC Release No. 33-9046.

**INSERT PAGE DIVIDER**

Please feel free to contact us if we can provide further information on these matters.

**John W. White**  
212-474-1732  
jwhite@cravath.com

**C. Allen Parker**  
212-474-1765  
aparker@cravath.com

**Marc S. Rosenberg**  
212-474-1676  
mrosenberg@cravath.com

**Susan Webster**  
212-474-1660  
swebster@cravath.com

**Alyssa K. Caples**  
212-474-1074  
acaples@cravath.com

# SEC Approves Amendment to NYSE Rule 452, Eliminating Broker Discretionary Voting in Uncontested Director Elections

July 1, 2009

At an Open Meeting today, the Securities and Exchange Commission approved an amendment to New York Stock Exchange Rule 452, *Giving Proxies by Member Organizations*.<sup>1</sup> As a result, uncontested director elections held on or after January 1, 2010 will be considered “non-routine” for all U.S. public companies<sup>2</sup> other than those registered under the Investment Company Act of 1940, and brokers will be prohibited from voting on these matters without specific instructions from beneficial owners. The amended Rule applies to all voting by brokers who are members of the NYSE and is not limited to companies listed on the NYSE.

## BACKGROUND

**“The most fundamental way in which shareholders can ensure that directors remain accountable to them is through the director election process. The NYSE’s proposal is designed to help assure that voting rights for matters as critical as the election of directors are exercised by those with an economic interest in the company, rather than by brokers, thereby improving corporate governance and enhancing accountability.”**  
- Chairman Mary Schapiro,  
July 1, 2009.

Rule 452 allows brokers to exercise discretionary voting on behalf of shareholders in all “routine” matters if brokers do not receive voting instructions from beneficial owners at least 10 days before a company’s scheduled shareholder meeting. Prior to today’s amendment, the Rule categorized uncontested director elections as “routine”. The Rule was originally designed to help companies more easily establish a quorum and conduct business at shareholder meetings. Discretionary broker votes are most often cast on behalf of individual retail shareholders and typically follow managements’ recommendations, including for election of directors.

In 2005, the NYSE established a proxy working group consisting of companies, brokers, lawyers, institutional shareholders and other market constituents to examine proxy voting in general and broker discretionary voting in uncontested director elections in particular. Citing the authority that directors have “over the most fundamental issues of corporate governance” and “the critical role directors play in the life of a corporation”, the proxy working group recommended in its 2006 report that the election of directors should not be considered “routine” and that broker discretionary voting in uncontested director elections should not be permitted. The SEC explained today that the amendment is designed to enhance corporate governance and accountability by helping assure that shareholders with economic interest in the company vote on the election of directors and to address concerns that broker discretionary voting for directors has impacted election results.

The NYSE initially submitted a proposed amendment to Rule 452 to the SEC in 2006, but the required public comment process was not initiated until March 6, 2009, approximately

<sup>1</sup> The SEC also voted to codify two previously published interpretations under Rule 452 that do not permit broker discretionary voting for material amendments to investment advisory contracts with an investment company. In addition, the SEC today also voted to propose (1) amendments to rules relating to proxy disclosure and solicitations (please see our client memo entitled “SEC Proposes Proxy Disclosure Enhancements”), (2) clarifying amendments to the proxy solicitation rules and (3) new rules relating to shareholder approval of executive compensation of TARP recipients.

<sup>2</sup> This change will generally not impact foreign companies listed in the U.S. because Rule 452 already treats solicitations using proxy statements that are not comparable to those required under the U.S. proxy rules as “non-routine”.

one month after Chairman Mary Schapiro started her term. Stock exchange rules are normally approved by the SEC Staff, but in this case there was full Commission consideration. The Commission vote was split 3-2 along the same lines as its vote on proposed shareholder proxy “access” in May. Chairman Schapiro and Commissioners Aguilar and Walter voted in favor of the amendment, while Commissioners Casey and Paredes voted against. All five Commissioners noted a number of concerns about the implementation of the new rule and the need to address shareholder communications and other proxy voting issues. Chairman Schapiro noted that the Commission would be studying these “proxy plumbing” issues this year.

## **IMPACT OF TODAY’S AMENDMENT**

### **Lower retail vote with corresponding shift of voting power to institutional shareholders and increase in influence of proxy advisory firms.**

According to a Broadridge analysis of the 2009 proxy season, brokers on average exercised voting discretion over approximately 18.1%<sup>3</sup> of the shares processed through Broadridge. As noted above, uninstructed shares are typically held by retail shareholders who often do not provide voting instructions to their brokers. Consequently, today’s amendment will likely result in a potentially significant decrease in voting by retail shareholders and a proportionate increase in the voting power of institutional shareholders. This increase in institutional shareholder voting power also will elevate the influence of proxy advisory firms to the extent that institutional shareholders rely on proxy advisory firms’ recommendations.

### **Companies with majority voting provisions or facing “vote no” campaigns may find election of directors more difficult.**

For companies with majority voting in uncontested director elections, today’s change effectively eliminates a bloc of votes that historically has helped director nominees achieve majority votes. Without these votes, companies subject to majority voting may have difficulty electing directors, especially those companies that historically have had a high percentage of retail ownership. Shareholder activists’ and special interest groups’ “vote no” campaigns against directors also are likely to be more effective.

### **Continued use of e-proxy notice and access provisions may result in even lower levels of retail voting.**

A June 2008 Broadridge survey showed that the 653 companies that elected to use e-proxy during the 2008 proxy season saw a 52% drop in total instructed retail votes cast compared to the prior season. Despite the drop in instructed retail votes, the uninstructed shares were still largely voted by brokers exercising their discretion on “routine” matters. After today’s amendment, those shares will no longer be voted in uncontested director elections. This could be of particular concern to companies in the context of majority voting requirements and “vote no” campaigns.

### **Difficulties faced by companies in communicating directly with beneficial owners of shares under existing rules will become more significant.**

Under the SEC rules, companies only have access to the names and addresses of beneficial owners who hold their shares in “street name” if the beneficial owners do not elect to withhold their identities (Non-Objecting Beneficial Owners, or “NOBOs”). Approximately 70-80% of all public companies’ shares are held in “street name”, but NOBOs represent only approximately 25% of the shares held in “street name”. Thus, companies are unable to directly communicate with the owners of approximately 50-60% of their outstanding shares (Objecting Beneficial Owners, or “OBOs”), making it difficult for companies to conduct outreach to these shareholders and encourage them to vote.

### **Increased costs to solicit proxies.**

After today’s amendment, companies will likely incur higher costs to solicit proxies, particularly if they have majority voting provisions or if they are trying to defend against “vote no” campaigns. Engaging proxy solicitation firms to help reach more shareholders, accelerating the proxy statement preparation process to allow for greater time to solicit proxies in advance of shareholder meetings and issuing supplemental proxy materials to follow up with shareholders all will increase the cost of soliciting proxies.

### **Achieving a quorum might be more difficult.**

After today’s amendment, achieving a quorum might be more difficult for some companies. A vote on just one “routine” matter results in broker discretionary votes counting towards a quorum. But with uncontested elections now no longer considered “routine”, if a company does not include some other “routine” matter on its shareholder meeting agenda, sufficient votes to

<sup>3</sup> Represents the level of broker discretionary voting processed by Broadridge at public companies, the shares of which are held in 300,000 shareholder accounts or more.

achieve a quorum might not be present. However, this problem will likely be limited to a few companies as most companies regularly have at least one “routine” matter, such as the ratification of the appointment of the company’s auditors, on the agenda for their shareholder meetings.

## **RECOMMENDED ACTIONS**

Increased shareholder education was recognized by all the Commissioners as an important and necessary companion to today’s amendment. Specifically, the SEC Staff explained that they envision investor education efforts by a subcommittee of the NYSE proxy working group, supported by the SEC’s Office of Investor Education. In addition, the SEC Staff anticipate that companies will engage in their own outreach efforts to shareholders. It will be incumbent upon companies to make a more concerted effort to communicate with and educate their shareholders, primarily their retail shareholders, regarding director elections if companies are to maintain historical levels of voting participation. This need will be particularly acute for companies that have majority vote provisions or that are facing “vote no” campaigns.

Companies may wish to consider taking the following actions:

- educating shareholders about the change in the rules and the importance of their votes
- reconsidering the use of the notice and access model under the e-proxy rules, including increased use of mailing to retail holders
- preparing and mailing proxy materials as early as possible to ensure ample time for materials to reach beneficial owners from the brokers’ clearing houses
- engaging a proxy solicitor to conduct direct outreach to NOBOs
- where appropriate, preparing supplemental proxy materials and following up with shareholders to ensure maximum participation

## **LOOKING AHEAD**

The vote to approve today’s amendment to Rule 452, almost three years after the NYSE submitted its initial draft amendment to the SEC and yet only six months after Chairman Schapiro’s term began, shows Chairman Schapiro’s commitment to move quickly and demonstrate progress on matters relating to corporate governance and accountability. This second 3-2 vote (following the SEC’s recent 3-2 vote to propose shareholder proxy “access” rules) also demonstrates Chairman Schapiro’s willingness to move forward on these issues even without consensus.

*This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.*

### **New York**

Worldwide Plaza  
825 Eighth Avenue  
New York, NY 10019-7475  
212.474.1000

### **London**

CityPoint  
One Ropemaker Street  
London EC2Y 9HR  
+44.20.7453.1000

[www.cravath.com](http://www.cravath.com)

**INSERT PAGE DIVIDER**

Please feel free to contact us if we can provide further information on these matters.

**John W. White**  
212-474-1732  
jwhite@cravath.com

**C. Allen Parker**  
212-474-1765  
aparker@cravath.com

**Susan Webster**  
212-474-1660  
swebster@cravath.com

**LizabethAnn R. Eisen**  
212-474-1930  
lizann.eisen@cravath.com

**Eric W. Hilfers**  
212-474-1352  
ehilfers@cravath.com

**Alyssa K. Caples**  
212-474-1074  
acaples@cravath.com

**Jennifer S. Conway**  
212-474-1316  
jconway@cravath.com

**“Proxy statements are among the most significant communications between a company and its owners, and they also are central to the only process through which owners formally and regularly participate in the governance of the corporation.”**

– Chairman Mary Schapiro,  
July 1, 2009.

## SEC Proposes Proxy Disclosure Enhancements

July 2, 2009

At an Open Meeting held on July 1, 2009,<sup>1</sup> the Securities and Exchange Commission proposed several new disclosure requirements designed to enhance the information included in proxy and information statements. The proposing release, which we expect to be available shortly on the SEC’s website at [www.sec.gov](http://www.sec.gov), will be subject to a 60-day public comment period following its publication in the Federal Register. The proposal contemplates that the final rules will be applicable to proxy and information statements beginning in 2010. The following summary is based on the discussion at the Open Meeting.

### PROPOSED RULES RELATED TO DISCLOSURE OF COMPENSATION MATTERS

The Commission voted to propose the following amendments to the proxy rules with respect to compensation disclosure:

- **An amendment to the Compensation Discussion and Analysis requirements of Item 402 of Regulation S-K that would require a company to discuss and analyze its broader compensation policies and overall compensation practices for employees generally, including non-executive officers, if the risks arising from these policies and practices may have a material effect on the company.**

During the Open Meeting, Meredith Cross, the Director of the SEC’s Division of Corporation Finance, clarified that the proposed amendments do not seek information about the overall risk management policies or overall compensation practices of a company. Rather, if a company determines that a compensation policy or practice may materially affect the company’s financial condition or results of operations, the company would be required to include targeted disclosure regarding such policy or practice. The SEC Staff noted that the situations requiring disclosure will vary depending on the particular company and its compensation policies. In addition, Director Cross observed that the proposed amendments do not alter existing disclosure requirements with regard to named executive officers, which already require companies to disclose the relationship between the compensation of their named executive officers and their risk management policies if risk is a material element of the compensation of such executive officers.

Companies may wish to review their compensation policies and practices at this time to identify and evaluate any associated material risks. If a company determines that it may be required to provide targeted disclosure, it may wish to consider what such disclosure might look like and whether modification of any of its compensation policies or practices ahead of next year’s proxy season is desirable.

<sup>1</sup> Also at the July 1, 2009 meeting, the SEC voted to propose clarifying amendments to rules relating to proxy solicitations and new rules relating to shareholder approval of executive compensation of Troubled Asset Relief Program recipients and approved an amendment to NYSE Rule 452, eliminating broker discretionary voting in uncontested director elections for all U.S. public companies other than those registered under the Investment Company Act. For more information on the amendment to NYSE Rule 452, please see our client memo entitled “SEC Approves Amendment to NYSE Rule 452, Eliminating Broker Discretionary Voting in Uncontested Director Elections”.

- **An amendment to the proxy rules requiring the disclosure of the fees and services provided by compensation consultants and their affiliates, if those consultants or affiliates provide consulting services related to executive or director compensation and also provide additional services to the company.**

The proposed amendment would require disclosure of (1) the additional services provided by the consultant or any of its affiliates to the company, (2) the aggregate fees paid for all such additional services and the aggregate fees paid for work related to executive and director compensation consulting, (3) whether the decision to engage the consultant for any other services was recommended or made by management and (4) whether the board, or the company's compensation committee, approved the other services.

Companies may wish to review their relationships with their compensation consultants at this time, paying special attention to any current or potential conflicts of interests. As part of this review, companies may wish to consider what new disclosure would be required and whether any modifications to such consultants' terms of service are desirable ahead of next year's proxy season.

- **An amendment revising the disclosure of stock and option awards in the Summary Compensation Table and the Director Compensation Table to require inclusion of the full grant-date fair value, as computed under Statement of Financial Accounting Standards No. 123R ("FAS 123R"), of such awards.**

The proposed amendment would replace the current requirement, which was adopted in a controversial action taken by the SEC in December 2006, to disclose only the dollar amount recognized for financial reporting purposes under FAS 123R (*i.e.*, the amount determined by amortizing the grant-date fair value of awards over their vesting periods) in lieu of the full grant-date fair value in the year of the grant. This change may affect the composition of the group of officers who are identified as the company's named executive officers (for both the proxy rules and Section 162(m) of the Internal Revenue Code).

Companies should consider identifying at this time any persons who may become named executive officers as a result of the proposed change and begin collecting and tracking their relevant compensation information. The rule change also raises a number of transition issues, particularly with respect to previously granted awards and comparative disclosure for prior years, that we anticipate the SEC will address in the proposing release.

## **PROPOSED RULES RELATED TO THE DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES**

The Commission voted to propose the following amendments to the proxy rules regarding corporate governance disclosure:

- **An amendment to Item 401 of Regulation S-K requiring companies to disclose for each director and director nominee (whether nominated by the company or another proponent) the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the company, and as a member of any committee on which the person serves or is chosen to serve, in light of the company's business.**

The SEC also proposed amendments to (1) require the disclosure of any public company directorships held by a director or nominee at any time during the last five years (the existing rules only require disclosure of current directorships) and (2) lengthen the look-back period for disclosure of legal proceedings involving the director or nominee from five to ten years. In addition, Commissioner Aguilar noted that the SEC will seek comments concerning disclosures related to board diversity, including whether companies should be required to disclose if diversity is a factor their nominating committee considers when selecting a board candidate and provide additional or different disclosure related to diversity.

At this time, companies may wish to gather, to the extent available, the relevant information that may be subject to disclosure and consider what their additional disclosure might look like. Given the SEC's recent focus on risk management, companies may wish to highlight any risk management expertise of their directors and nominees in such disclosure. In addition, companies may also wish to review the composition of their various board committees with these additional disclosure requirements in mind.

- **Amendments to Item 407 of Regulation S-K and Schedule 14A requiring disclosure of a company’s leadership structure and a discussion of why the company believes its leadership structure is the best structure for the company.**

A company would be required to disclose whether and why it combines or separates the positions of chief executive officer and chairman of the board and whether it has a lead independent director. A company also would be required to disclose the role of its board in the company’s risk management process, and the effect, if any, this role has on the organization of its leadership structure.

Companies may wish to analyze their board and management structures and consider the scope of the proposed disclosure rules and whether any changes to those structures are advisable ahead of next year’s proxy season.

### **PROPOSED RULE FOR EARLY REPORTING OF PROXY VOTING RESULTS**

The Commission also voted to propose the following rule regarding the disclosure of the outcome of shareholder votes:

- **Creation of a new item under Form 8-K requiring companies to disclose the results of shareholder votes within four business days after the end of the meeting at which the vote was held.**

This proposed change would significantly accelerate the timing for reporting voting results, which previously were only required to be disclosed in the company’s Form 10-Q, or Form 10-K, following the vote. Neither the SEC Staff nor the Commissioners discussed how the proposed rule would address shareholder votes that are not certified within four business days of the meeting.

### **CONCLUSION**

These proposed amendments are an important step forward in advancing the SEC’s agenda to increase corporate transparency through additional disclosure requirements. Chairman Schapiro, however, has noted that “disclosure only takes us so far” and that the ability of shareholders to exercise their legal rights to nominate directors should also be enhanced. As part of this effort, the SEC proposed rules in May 2009 expanding shareholder access to company proxy statements, thereby making it easier and less expensive for shareholders to nominate and elect directors.<sup>2</sup> Public companies should expect these recent trends to continue.

*This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.*

**New York**  
Worldwide Plaza  
825 Eighth Avenue  
New York, NY 10019-7475  
212.474.1000

**London**  
CityPoint  
One Ropemaker Street  
London EC2Y 9HR  
+44.20.7453.1000

www.cravath.com

---

<sup>2</sup> For more information on these “proxy access” rules, please see our memo entitled “SEC Proposes New Rule to Expand Shareholder Access to Corporate Proxies”.