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The SEC's Proposed Proxy Access Rules, Related Delaware Law Changes, and Proposed Federal Corporate Governance Legislation

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On June 10, 2009, the SEC published a comprehensive series of proposed rule amendments that would provide shareholders with access to the proxy statements of most public companies for the purpose of electing directors, otherwise known as "proxy access." Currently, shareholders must file and distribute their own proxy materials and engage in an expensive proxy fight if they want to seek to elect their own director candidates. The SEC has also proposed to amend its shareholder proposal rules to allow shareholder proposals that, if approved by stockholders, would facilitate alternative proxy access regimes that would substitute for the SEC's baseline regime. Proxy access has been a highly controversial topic that has been the subject of two prior SEC proposals as well as significant litigation.[1]

On April 10, 2009, certain amendments to the Delaware General Corporation Law (the "DGCL") were signed into law that, among other things, facilitate both proxy access and the reimbursement of proxy solicitation expenses. Moreover, on May 19, 2009, Senators Charles Schumer (D-NY) and Maria Cantwell (D-WA) introduced a bill entitled "Shareholder Bill of Rights Act of 2009," which, among other things, would instruct and authorize the SEC to adopt proxy access rules, thereby preempting state law and eliminating any debate over whether the SEC has authority to implement the proposed proxy access rules. Finally, on June 12, 2009, Congressman Gary Peters (D-MI) introduced federal legislation entitled "Shareholder Empowerment Act," which also provides for proxy access.

While the SEC's proposed proxy access rules are subject to comment and modification, given the recent amendments to the DGCL and the current political climate surrounding the introduction of federal corporate governance legislation, it is increasingly likely that stockholders will be afforded significantly expanded access to the proxy statements of public companies for the purpose of nominating directors. Accordingly, the remainder of this client alert provides an overview of:

- the SEC's proposed proxy access rules;
- proposed changes to the SEC's shareholder proposal rules to facilitate alternative proxy access regimes;
- recent amendments to the DGCL that take effect on August 10, 2009, including those relating to proxy access and reimbursement of proxy solicitation expenses and other matters;
- the proposed federal Shareholder Bill of Rights Act of 2009; and

- the proposed Shareholder Empowerment Act.

The SEC's Proposed Proxy Access Rules

Background

Following the May 20, 2009 3-2 split vote to propose new proxy access rules, the SEC issued a proposing release on proxy access entitled "Facilitating Shareholder Director Nominations" (the "Release"). Comments on the Release are due on or before August 17, 2009. This is third time the SEC has proposed proxy access rules. Given the long history and heated nature of debate about proxy access, we expect the SEC will receive a large number of comments both supporting and opposing the proposed rules and that the proposed rules may change significantly before they are adopted, if they are adopted at all. While certain business groups have requested more time to provide comments, final proxy access rules may be in effect for the 2010 proxy season.

The proposed rules require a company to include a limited number of shareholder director nominees in its proxy materials under specified circumstances as long as the nominating shareholders are not seeking to effect a change in control of the company. In the Release, the SEC emphasized that "[t]he proxy rules seek to improve the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual in-person meeting of shareholders," and that allowing proxy access furthers that objective by facilitating the exercise of rights granted to shareholders under state law to nominate and elect directors at shareholder meetings.

Proposed Changes to the Proxy Rules

The following is a general summary of the proposed changes to the SEC's proxy rules.

New Rule 14a-11—Shareholder Nominations

General. The SEC has proposed new Rule 14a-11, which would apply to all companies subject to the proxy rules, except companies subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act"). Under Rule 14a-11, a company would be required to include in its proxy materials for a meeting at which directors are elected the name and other specified information about a limited number of shareholder nominees and about the shareholders that nominated the nominee or nominees, provided that:

- applicable state law or the company's governing documents do not prohibit shareholders from nominating directors;
- the nominees' candidacy or board membership would not violate state law, the registrant's governing documents, federal law, or rules of a stock exchange (other than rules of a stock exchange relating to director independence); and
- all the specified information is included in the required notice on new Schedule 14N ("Schedule 14N").

Ownership Requirements. Rule 14a-11 requires that a nominating shareholder or a nominating shareholder group (referred to herein as a nominating shareholder) beneficially own a specified percentage of the subject company's voting stock on the date the nominating shareholder provides notice to the company on Schedule 14N, as follows:

- for large accelerated filers[2] and investment companies registered under the Investment Company Act of 1940 with net assets of $700 million or more, at least 1% of the large accelerated filer's or investment company's securities entitled to vote on the election of directors;
- for accelerated filers[3] and investment companies with net assets of $75 million or more but less than $700 million, at least 3% of the accelerated filer's or investment company's securities entitled to vote on the election of directors; and
- for non-accelerated filers[4] and investment companies with net assets of less than $75 million, at least 5% of the non-accelerated filer's or investment company's securities entitled to vote on the election of directors.

In determining whether the requisite ownership percentages above are met, under the proposed rules, nominating shareholders may rely on the following (unless they know or have reason to know that the relevant information is inaccurate):

- for companies other than investment companies, the company's most recent quarterly or annual report and any current report subsequent thereto, filed with the SEC;
- for companies that are "series" companies defined in Rule 18f-2 under the Investment Company Act, the information contained in a Form 8-K that would be required to be filed by the series company within four business days after it determined the anticipated meeting date, disclosing its net assets as of June 30 of the calendar year immediately preceding the calendar year of the meeting and the total number of the company's shares that are entitled to vote for the election of directors at the annual meeting (or special meeting in lieu of the annual meeting) as of the most recent calendar quarter; and
- for other investment companies, the investment company's most recent annual or semi-annual report filed with the SEC on Form N-CSR.

Shareholder Notice. To have a nominee or nominees included in a company's proxy materials, the nominating shareholder must provide written notice to the subject company on Schedule 14N and include disclosures specified in new Rule 14a-18. The Schedule 14N must be filed with the SEC on the same date it is provided to the company.

Number of Shareholder Nominees. A company is not required to include in its proxy statement and form of proxy more than one shareholder nominee or the number of nominees equal to 25% of its board of directors, whichever is greater.[5] In addition, where a company has one or more directors on its board that were elected as shareholder nominees pursuant to Rule 14a-11 and the term of that director or those directors extends past the meeting of stockholders for which the company is soliciting proxies, the company will not be required to include in its proxy statement or form of proxy more shareholder nominees than could result in the total number of directors who are elected as shareholder nominees pursuant to Rule 14a-11 and serving on the board being more than one shareholder nominee or 25% of the company's board of directors, whichever is greater.

Race to Submit Schedule 14N. To the extent more than one shareholder or shareholder group submits Schedule 14Ns such that the total number of shareholder nominees exceeds the number of shareholder nominees permitted by Rule 14a-11, the first shareholder submitting a Schedule 14N will be the shareholder entitled to include its nominee or nominees in the registrant's proxy statement and form of proxy. If the first nominating shareholder does not nominate the maximum number of

nominees, the subject company must take additional shareholder nominees in the order in which it receives timely notice on Schedule 14N.

Subject Company Not Responsible for False or Misleading Statements of Nominating Shareholder. The subject company is not responsible for any statements made by a shareholder nominee or the nominating shareholder in its Schedule 14N, unless the company knows or has reason to know that the information is false or misleading.

Procedure to Exclude a Proposed Shareholder Nominee From Proxy Materials. Rule 14a-11 provides a procedure pursuant to which a subject company may seek to exclude a shareholder nominee from its proxy statement or proxy card if the nominating shareholder or group has not complied with applicable rules or procedures or the shareholder nominee does not meet certain eligibility requirements. The process is very similar to the process required to be followed if a company wants to exclude a shareholder proposal from its proxy statement under Rule 14a-8, and, unless the company can persuade the nominating shareholder to withdraw its nominee or nominees, the company must obtain a no-action letter from the SEC staff to exclude the nominee or nominees from its proxy materials. A company or a nominating shareholder may, however, always seek a judicial determination of their respective rights if they do not agree with the position taken by the SEC staff. All materials submitted to the SEC in connection with an attempt to exclude a nominee from a company's proxy materials would be publicly available immediately upon submission.

New Rule 14a-18—Information to Be Included in the Schedule 14N Notice for Shareholder Nominees Submitted Pursuant to Rule 14a-11

General. The SEC has proposed new Rule 14a-18, which sets forth the informational requirements for the notice on Schedule 14N.

Timing of Notice to Be Provided to Company. The nominating shareholder must send its Schedule 14N to the subject company by the date specified in the company's advance notice bylaw or, where no such bylaw exists, no later than 120 days before the date that the subject company mailed its proxy materials for the prior year's meeting. If the subject company did not hold an annual meeting during the prior year, or if the date of that meeting is moved by more than 30 calendar days, then the nominating shareholder must provide and file its notice a reasonable time before the registrant mails its proxy materials, as specified by the registrant in a Form 8-K filed pursuant to proposed new Item 5.07 of Form 8-K, which is discussed below. The Schedule 14N would be required to be filed with the SEC on the same date as it is sent to the company.[6] The Schedule 14N notice must include:

- a representation that the nominee's candidacy or board membership would not violate controlling state law, federal law, or rules of a national securities exchange (other than the rules of a national securities exchange regarding director independence);
- a representation that the nominating shareholder satisfies the eligibility conditions set forth in Rule 14a-11(b), including a statement regarding the nominating shareholder's beneficial ownership of the subject securities and intent to continue holding the securities through the date of the meeting;
- with respect to a company other than an investment company, a representation that the nominee meets the objective criteria for "independence"[7] of the national securities exchange, if any, on which the company is listed or, in the case of a company that is an investment company, a

representation that the nominee is not an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act;

- a representation that there is no agreement between the subject company and the nominating shareholder (or any member of a nominating shareholder group) with respect to the nomination of the shareholder nominee;
- a statement from the nominee that he or she consents to be named in the proxy statement and to serve on the subject company's board if elected;
- information about the shareholder nominee that is required to be disclosed under the proxy rules for a director nominee;
- information about the nominating shareholder consistent with what is currently required to be disclosed in a proxy statement with respect to a solicitation and solicitation participants in a contested election contest;
- disclosure of certain relationships between the nominating shareholder or the nominee and the registrant or any affiliate of the registrant;
- disclosure regarding certain material pending or threatened litigation involving the nominating shareholder or the nominee and the subject company or its affiliates;
- the website address on which the nominating shareholder may publish soliciting materials, if any; and
- any statement in support of the shareholder nominee or nominees, which may not exceed 500 words, if the nominating shareholder elects to have such statement included in the subject company's proxy materials.

New Rule 14a-19—Schedule 14N Notice Requirements for Shareholder Nominees Submitted Pursuant to Applicable State Law or a Company's Governing Documents

Rule 14a-19 is similar to Rule 14a-18, except that it covers a situation where a nominating shareholder submits a nominee for election pursuant to applicable state law or a company's governing documents, not Rule 14a-11. Because the rules governing disclosure with respect to these types of nominees will be varied, Rule 14a-19 requires less disclosure than Rule 14a-18, which specifically relates to Rule 14a-11. Presumably, there would be disclosure requirements under state law or a company's governing documents. Rule 14a-19 does, however, seek to ensure that nominating shareholders provide disclosure similar to the disclosure required in a contested election and many of the disclosure requirements of Rule 14a-18 also appear in Rule 14a-19.

Requirements With Respect to Schedule 14N

The SEC has proposed new Regulation 14N, which governs filings on Schedule 14N by nominating shareholders. In addition to requiring nominating shareholders to file a Schedule 14N, Regulation 14N requires, among other things, a nominating shareholder to "promptly" file an amendment to its Schedule 14N whenever there is a material change in the information set forth in Schedule 14N. One item of Schedule 14N that we believe is controversial, is a requirement that a nominating stockholder disclose its intent with respect to its continued ownership of the subject company's securities after the election in its original Schedule 14N and a requirement to amend its Schedule 14N within 10 calendar

days of the announcement of the final results of the election disclosing its intention with respect to continued ownership of the subject company's securities. It is expected that the investor community will resist these requirements, as disclosing an intent to sell may put downward pressure on a company's stock price, which is exactly what a selling stockholder would not want to happen.

Schedule 14N also requires the nominating shareholder to certify that, to the best of its knowledge, the voting securities it holds in the subject company are not held for the purpose of or with the effect of changing control of the issuer of the securities or to gain more than a limited number of board seats. As pointed out in the Release, this requirement could be problematic, as a person's intent with respect to control could change over time. The SEC has requested comment with respect to whether it should require a shareholder to represent that it will not seek to effect a change in control of the subject company or gain more than a limited number of board seats for a specified period of time after the election of directors.

The information included in the Schedule 14N for inclusion in the subject company's proxy materials would be subject to new paragraph (c) of Rule 14a-9, which prohibits false and misleading statements by a nominee or nominating shareholder in connection with the shareholder nomination of a director.

Amendments to Schedule 14A

As proposed, Schedule 14A would be amended to require a company to include most of the information submitted by a shareholder nominee on Schedule 14N in the company's proxy materials, including the shareholder nominee's statement in support of its nominee or nominees.

*Exemption From Proxy Rules for **Written** Solicitations in Connection With the Formation of a Nominating Shareholder Group Pursuant to Rule 14a-11*

The SEC has proposed a new exemption from its proxy solicitation rules (other than Rule 14a-9, which prohibits false and misleading solicitations) that would allow written communications by a nominating shareholder in connection with the formation of a shareholder group pursuant to Rule 14a-11, provided that:

- Each written communication contains no more than:
    - a statement of each soliciting shareholder's intent to form a nominating shareholder group to nominate a director under Rule 14a-11;
    - identification of, and a brief statement regarding, the potential nominee or nominees or, where no nominee or nominees have been identified, the characteristics of the nominee or nominees that the shareholder intends to nominate, if any;
    - the percentage of securities that each soliciting shareholder beneficially owns or the aggregate percentage owned by any group to which the shareholder belongs; and
    - information with respect to how shareholders may contact the soliciting party.

This soliciting material would have to be filed with the SEC by the nominating shareholder under cover of Schedule 14A no later than the date it is first published, sent, or given to shareholders and at the same time be filed with or mailed to each national securities exchange upon which any class of securities of the registrant is listed and registered.

This exemption would allow a shareholder to put out a notice to the world seeking persons to join a group for the purpose of nominating directors under Rule 14a-11. However, as currently proposed, this exemption does not cover solicitations where shareholders are seeking to nominate a director under applicable state law or a company's governing documents. In addition, oral solicitations would not be permitted under this proposed rule.

Shareholders would have to rely on other exemptions in these contexts, such as Rule 14a-2(b)(2), which exempts solicitations made by persons other than the subject company where the total number of persons solicited is not more than 10.

*Exemption From Proxy Rules for **Oral or Written** Solicitations by or on Behalf of a Nominating Shareholder in Support of Its Rule 14a-11 Nominee or Nominees*

The SEC has proposed a second new exemption from its proxy solicitation rules (other than Rule 14a-9, which prohibits false and misleading solicitations) that would allow any oral or written solicitation by or on behalf of a nominating shareholder in support of a nominee placed on a company's form of proxy in accordance with Rule 14a-11, provided that:

- The soliciting party does not, at any time during such solicitation, seek the power to act as proxy for a shareholder;
- Each written communication includes:
    - The identity of each nominating shareholder and a description of his or her direct or indirect interests, by security holdings or otherwise;
    - A specified legend that, among other things, advises shareholders to read the subject company's proxy statement because it contains important information; and
- Any soliciting material published, sent, or given to shareholders under this new exemption must be filed by the nominating shareholder with the SEC under cover of Schedule 14A no later than the date the material is first published, sent, or given to shareholders and must at the same time be filed with or mailed to each national securities exchange upon which any class of securities of the registrant is listed and registered.

These solicitations could be made through a designated website, a press release, or otherwise.

In addition, as currently proposed, this exemption does not cover soliciting activities in support of a shareholder nominee where shareholders have nominated a director under applicable state law or a company's governing documents. Shareholders would have to rely on other exemptions in these contexts, such as Rule 14a-2(b)(2), which exempts solicitations made by persons other than the subject company where the total number of persons solicited is not more than 10.

Amendments to Rule 14a-4 to Prohibit Voting for a Company's Nominees as a Group When Shareholder Nominees Are Included on the Proxy Card

Under Rule 14a-4, a company may currently design its proxy card so that shareholders have the ability to vote for (or withhold authority to vote for) all of the company's nominees as a group, as long as shareholders are given the means to withhold voting authority for specific nominees within the group. As proposed, Rule 14a-4 would be amended to provide that, if a shareholder nominee is

included on company's proxy card, the company would not be permitted to group its nominees together and must design its proxy card so that each nominee could be voted on separately.

Amendment to Rule 14a-6 to Provide That Preliminary Proxy Materials Do Not Need to Be Filed Because a Proxy Statement Contains a Shareholder Nominee

The SEC has proposed amending Rule 14a-6 so that preliminary proxy materials do not need to be filed merely because those materials contain a director that has been nominated pursuant to Rule 14a-11, applicable state law, or a company's governing documents. Accordingly, proxy materials that include a shareholder nominee could be filed in definitive form and would not be subject to SEC staff review, provided they did not contain some other proposal requiring the filing of preliminary materials.

New Item 5.07 of Form 8-K

The proxy access proposal also contemplates new Item 5.07 of Form 8-K, which would require certain disclosures relating to the timetable for submission of shareholder nominations if a company did not hold an annual meeting during the previous year, or if the date of the annual meeting has been changed by more than 30 calendar days from the date of the prior year's meeting. In such cases, the company would be required to disclose the date by which a nominating shareholder must submit its Schedule 14N, and that date must be a reasonable time before the registrant mails its proxy materials for the meeting. For companies that are "series" companies defined in Rule 18f-2 under the Investment Company Act, Item 5.07 would also require disclosure of information about the company's net assets and total shares entitled to vote in the election of directors as discussed above under "—Proposed Changes to the Proxy Rules—New Rule 14a-11—Shareholder Nominations—Ownership Requirements." A late filing of an Item 5.07 Form 8-K would result in a company losing its eligibility to use Form S-3.

Amendments to Rule 13d-1 to Allow Passive Investors to Continue to File Schedule 13G Filings When Using Rule 14a-11

Any person who is directly or indirectly the beneficial owner of more than 5% of a class of equity securities of an issuer that is registered under Section 12 of the Exchange Act must report that ownership on a Schedule 13D. In determining whether the 5% ownership threshold is triggered, Rule 13d-5(b)(1) provides that, when two or more persons act together for the purpose of acquiring, holding, voting, or disposing of equity securities of an issuer, the group formed thereby will be deemed to have acquired beneficial ownership of all equity securities of that issuer beneficially owned by all members of the group. It would appear that persons would be acting together for the purpose of voting their securities in connection with the formation of a nominating shareholder group. Accordingly, the security holdings of all members of a nominating shareholder group would be aggregated in determining the 5% threshold for filing a Schedule 13D in addition to being aggregated for purposes of determining whether Rule 14a-11's ownership requirements are met.

Certain 5% beneficial owners qualify to use an abbreviated Schedule 13G, which has significantly reduced disclosure requirements from those required by Schedule 13D. In order to use a Schedule 13G, among other things, an investor must have acquired the subject securities with neither the purpose nor the effect of changing or influencing control of the company. The SEC has proposed changes to Rule 13d-1 to make it clear that a nominating shareholder or nominating shareholder group will still be able to use Schedule 13G if it engages in soliciting activities in connection with a

nomination under Rule 14a-11. No such relief from filing a Schedule 13D is provided if a nominating shareholder or nominating shareholder group submits its nomination pursuant to an applicable state law provision or a company's governing documents because, unlike Rule 14a-11, the applicable provisions in those circumstances may not limit the number of board seats for which a shareholder or group of shareholders may nominate candidates or include a requirement that the shareholder or shareholder group lack the intent to change control of the issuer or gain more than a limited number of board seats.

No Relief From Section 16 Requirements for Nominating Shareholder Groups

Under Section 16 of the Exchange Act and the rules promulgated thereunder, 10% beneficial owners of any class of equity security registered under the Exchange Act and each director and officer of the issuer of such security are:

- required to file Section 16 beneficial ownership reports;
- subject to disgorgement of "short-swing profits" (generally, "profits" made from the purchase and sale of securities made within six months of one another); and
- generally prohibited from short selling equity securities of that issuer.

The SEC has not provided any relief from the requirements of Section 16 of the Exchange Act for nominating shareholder groups that come together for the purpose of nominating directors pursuant to Rule 14a-11 or otherwise. Shareholder groups need to be mindful of Section 16's requirements if they form a group that beneficially owns more than 10% of a class of a company's equity securities.

Proposed Changes to the SEC's Shareholder Proposal Rules to Facilitate Alternative Proxy Access Regimes

In addition to allowing proxy access pursuant to Rule 14a-11, applicable state law, and a company's governing documents, the Release includes proposed amendments to Rule 14a-8(i)(8) that would change the SEC's current position and allow shareholder proposals relating to the adoption of amendments to a company's governing documents that would grant shareholders access to a company's proxy statement for the purpose of nominating directors. As discussed in our prior client alert,[8] Rule 14a-8(i)(8) currently provides that a shareholder proposal may be excluded from a company's proxy statement "[i]f the proposal relates to a nomination or an election for membership on the company's board of directors . . . or a procedure for such nomination or election." This provision permits companies to exclude shareholder proposals that would result in an immediate election contest or would set up a process pursuant to which shareholders could conduct an election contest in the future.

As amended, Rule 14a-8(i)(8) would, under specified conditions, require a company to include in its proxy materials shareholder proposals that would amend, or request an amendment to, a company's governing documents to allow proxy access, as long as the proposal does not conflict with Rule 14a-11 (*i.e.*, proposals that would preclude nominations by shareholders that would qualify to have their nominee included in the company's proxy statement under Rule 14a-11) or state law. Accordingly, the amendments to Rule 14a-8(i)(8) could facilitate a proxy access regime totally separate from that provided in Rule 14a-11 and with perhaps lower ownership thresholds and a shorter holding period than those in proposed Rule 14a-11.

The SEC has also proposed amending Rule 14a-8(i)(8) to codify prior SEC staff interpretations. As amended, Rule 14a-8(i)(8) would allow a company to exclude a shareholder proposal if it:

- would disqualify a nominee that is standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, character, or business judgment of one or more nominees or directors;
- nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision, or the company's governing documents; or
- otherwise could affect the outcome of the upcoming election of directors.

The proposed changes to the exclusion in Rule 14a-8(i)(8) combined with changes to the DGCL (discussed below) that would allow bylaw provisions to specifically provide for proxy access and the reimbursement of proxy solicitation expenses would permit shareholders of a Delaware corporation to submit bylaw amendments to a shareholder vote that could (i) facilitate proxy access on terms more favorable to shareholders than those provided for by proposed Rule 14a-11 and (ii) require a corporation to reimburse shareholders for their soliciting expenses in connection with a nomination of a director by a shareholder.

Recent Delaware General Corporation Law Amendments

On April 10, 2009, the governor of Delaware signed into law certain amendments to the DGCL, which will become effective on August 1, 2009. These amendments:

- permit the adoption of a bylaw to allow stockholders of Delaware corporations to include one or more of their director nominees in management's proxy materials (DGCL § 112);
- permit the adoption of a bylaw providing for the reimbursement of a stockholder's soliciting expenses in connection with an election of directors (DGCL § 113);
- allow a board to set a record date for stockholders entitled to vote at a meeting of stockholders that is later than the record date for the stockholders entitled to notice of meeting of stockholders so that it is more likely that persons voting the shares are the persons who actually own the shares (DGCL § 213(a));[9]
- limit the ability of a Delaware corporation to eliminate a right to indemnification after the event triggering the indemnification right arises (DGCL § 145(f)); and
- provide a procedure by which a corporation (or a stockholder derivatively in the right of the corporation) may apply to have the Delaware Court of Chancery remove a director from office under certain circumstances (DGCL § 225(c)).

Proxy Access (DGCL § 112)

Under new Section 112 of the DGCL, a Delaware corporation's bylaws may provide that, if the corporation solicits proxies for the election of directors, the corporation may be required, to the extent and subject to such procedures and conditions as may be provided in the bylaws, to include in its proxy solicitation materials, in addition to nominees nominated by the board of directors, one or more

nominees submitted by stockholders. Section 112 also includes a nonexclusive list of procedures and conditions that the bylaws may impose before allowing proxy access, including the following:

- requiring a minimum record or beneficial ownership and/or duration of ownership by the nominating stockholder and defining beneficial ownership to take into account options or other derivative rights;
- requiring the nominating stockholder to submit specified information concerning the stockholder and the stockholder's nominee(s), including information regarding such person's ownership of the corporation's capital stock or derivative securities;
- conditioning eligibility upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require such inclusion;
- precluding nominations by a person if such person, any nominee of such person, or any affiliate or associate of such person or nominee has acquired or publicly proposed to acquire shares constituting a specified percentage of the voting power of the corporation within a specified period before the election of directors; and
- requiring the nominating stockholder to indemnify the corporation in respect of any loss arising as a result of any false or misleading information or statement submitted by the nominating stockholder in connection with a nomination.

Proxy Expense Reimbursement (DGCL § 113)

New Section 113 of the DGCL allows a Delaware corporation to include a provision in its bylaws providing for the reimbursement by the corporation of a stockholder's soliciting expenses in connection with an election of directors (regardless of whether the stockholder included its nominee in management's proxy materials or prepared and distributed its own proxy materials), subject to conditions that may be set forth in the bylaws. Section 113 also identifies a nonexclusive list of conditions that may be imposed on any such right to reimbursement, including the following:

- conditioning eligibility for reimbursement on the number or proportion of persons nominated by the stockholder seeking reimbursement or whether such stockholder previously sought reimbursement for similar expenses;
- limiting the amount of reimbursement based upon the proportion of votes cast in favor of one or more of the persons nominated by the stockholder seeking reimbursement, or upon the amount spent by the corporation in soliciting proxies in connection with the election; or
- limitations concerning elections of directors by cumulative voting.

Separation of the Record Date for Voting at Stockholder's Meeting From the Record Date for Notice of the Meeting (DGCL § 213(a))

Currently, Section 213(a) of the DGCL requires corporations to use the same record date, which must be no more than 60 nor less than 10 days before the meeting date, for both notice of a stockholder meeting and for determining who may vote at that meeting. Beginning on August 1, 2009, Delaware corporations will be able to bifurcate these record dates so that there can be one record date used to determine what stockholders are entitled to notice of the meeting, which must be no more than 60 nor less than 10 days before the meeting date, and a subsequent record date used to determine what

stockholders are entitled to vote at the meeting. The record date used to determine who is entitled to vote at the meeting can be any date prior to the meeting date. This change will increase the likelihood that the persons voting at the stockholder meeting are the persons who own the shares entitled to vote, which is not the case currently when a stockholder sells its shares after the record date, but prior to the meeting date.

Limitation on the Ability of Corporation to Eliminate Indemnification Rights After the Fact (DGCL § 145(f))

A second sentence has been added to Section 145(f) of the DGCL, which provides that, if there is a right to indemnification or advancement of expenses under a corporation's bylaws or certificate of incorporation, that right may not be impaired by an amendment to the corporation's bylaws or certificate of incorporation that occurs subsequent to the act or omission giving rise to the right of indemnification or advancement of expenses, unless the provision providing for such indemnification specifically provides that such right to indemnification or advancement of expenses may be retroactively eliminated.

Procedure to Have the Delaware Court of Chancery Remove a Director From Office Under Certain Circumstances (DGCL § 225(c))

New paragraph (c) of Section 225 of the DGCL provides a mechanism pursuant to which a corporation (or a stockholder derivatively in the right of the corporation) may apply to have the Delaware Court of Chancery remove a director from office. The right to apply to have a director removed is triggered if the director has been convicted of a felony in connection with the director's duties to the corporation, or if there has been a prior judgment on the merits that the subject director has committed a breach of the duty of loyalty in connection with his or her duties to the corporation. Upon such application, the Court of Chancery may remove a director from office if it determines that the director did not act in good faith in performing the acts resulting in the prior conviction or judgment and judicial removal is necessary to avoid irreparable harm to the corporation.

A Federal Shareholder Bill of Rights

Overview. The proposed Shareholder Bill of Rights Act of 2009 (the "Proposed Act") would provide stockholders with access to the proxy statements of U.S. public companies for the purpose of nominating individuals for election to a company's board of directors and to implement certain mandatory corporate governance standards. The Proposed Act lists several Congressional findings, including that:

- among the current economic and financial crisis in the United States has been the failure of corporate governance;
- in too many situations, executive management and boards of directors have failed in their most basic duties, which include:
    - enacting compensation policies that are linked to the long-term profitability of their institutions;
    - appropriately analyzing and overseeing enterprise risk; and
    - prioritizing the long-term health of their firms and their shareholders; and

- a key contributing factor to the failure of corporate governance was the lack of accountability of boards to their ultimate owners, the shareholders.

Proxy Access. The Proposed Act would direct the SEC to adopt rules that would provide shareholders beneficially owning at least 1% of a public company's voting securities for the two-year period preceding the next scheduled annual shareholders' meeting. While the proxy access component of the Proposed Act is duplicative of the SEC's proxy access proposal discussed above, the Proposed Act, if enacted into law, would provide specific authorization for the SEC to regulate the director nomination process, an area that has historically been left to the states. This could prevent future legal challenges to the SEC's authority to implement proxy access rules.

Annual "Say on Pay" Vote. The Proposed Act would provide shareholders with a nonbinding, advisory vote with respect to the compensation of executives in any situation (*e.g.*, an annual meeting, special meeting, or consent solicitation) where the SEC's proxy solicitation rules require "compensation disclosure." As currently drafted, the Proposed Act would not only require an advisory "say on pay" vote at a company's annual shareholder meeting, but would also require such a vote at a special shareholder meeting at which, for example, shareholders are voting to approve an amendment to a compensation benefit plan. The SEC would have one year from the date of enactment of the Proposed Act to issue final rules to implement this provision. So-called "say on pay" legislation has had strong supporters for years, including President Barack Obama, who, as a senator in 2007, introduced "say on pay" legislation in the Senate after it had passed in the House. While Senator Obama's legislation stalled in the Senate in 2007, some form of "say on pay" legislation is likely to pass this year.[10]

"Say on Pay" With Respect to Golden Parachute Compensation. The Proposed Act would require a nonbinding, advisory vote with respect to any compensation arrangements or understandings with "principal executive officers" concerning an acquisition, merger, consolidation, or proposed sale or other disposition of substantially all of the assets of an issuer, to the extent such agreements or understandings were not previously subject to an advisory vote of stockholders. The SEC would have one year from the date of enactment of the Proposed Act to issue final rules to implement this provision.

Corporate Governance Standards. In addition to mandating proxy access, the Proposed Act would require the SEC to adopt rules directing the national securities exchanges to prohibit the listing of any security of an issuer that is not in compliance with the corporate governance standards listed below. The SEC's rules would be required to provide appropriate procedures for an issuer to have an opportunity to get into compliance and to cure any defects.

- Separate Chairman and CEO – The chairman of the board of a company with securities listed on a national securities exchange (a "listed company") must be independent (as defined under the rules of the applicable exchange) and must not have previously served as an executive officer of the issuer.

- No Staggered Boards – All directors of listed companies would be required to stand for election annually. This would eliminate staggered boards, which are usually designed so that only one-third of the directors are elected annually. A staggered board can be used to prevent an insurgent from waging a proxy contest and obtaining control of a board of directors at a single annual meeting.

- Majority Voting in Uncontested Elections and Mandatory Resignation of Directors Not Elected by Majority – The Proposed Act would require a majority voting standard in uncontested director elections of listed companies. In addition, any director not elected by a majority vote would be

required to resign. The board would be required to accept that resignation and to also make the resignation effective within a specified period of time to be determined by the SEC.

- Risk Committee – A listed company would be required to establish a "risk committee," comprised entirely of independent directors, which would be responsible for the establishment and evaluation of the risk management practices of the listed company.

Likelihood of Passage of a Federal Shareholder Bill of Rights. We question whether the Proposed Act will be passed by Congress in its current form. However, certain elements of the Proposed Act, such as "say on annual pay" and the provision of federal authority for the SEC to implement proxy access, may overcome the opposition, pass, and be signed into law. Certain provisions of the Proposed Act, including the provision eliminating staggered boards, would be a highly unusual exercise of federal authority in an area that has been largely left to state regulation. The current financial crisis notwithstanding, we question whether there is support in the Congress for federal intrusion to such a degree into matters historically left to state law.

The Shareholder Empowerment Act

In addition to the Proposed Act, the Shareholder Empowerment Act introduced by Congressman Gary Peters would implement corporate governance reforms, many of which are duplicative of, or are similar to, provisions in the Proposed Act. The Shareholder Empowerment Act would:

- subject to cure provisions, require national securities exchanges to prohibit the listing of any security of an issuer that does not:
    - have majority voting for the election of directors;
    - have a procedure pursuant to which a director who is not elected to a new term offers to tender his or her resignation; and
    - provide public disclosure with respect to the board's decision regarding what action is taken with respect to the tender of a board member's resignation discussed above and the rationale for that decision;
- require the SEC to implement proxy access rules that would allow certain long-term investors to have proxy access by nominating their own director candidates;
- require the SEC to adopt rules that would eliminate uninstructed broker votes in uncontested director elections, *i.e.*, brokers would no longer be permitted to vote shares for which they have not received voting instructions from beneficial owners in uncontested director elections;[11]
- subject to cure provisions, require national securities exchanges to prohibit the listing of a company that does not have an "independent" chairman;
- implement nonbinding annual shareholder approval of executive compensation;
- require the SEC to implement rules requiring compensation consultants to be independent and prohibiting issuers from indemnifying or limiting the liability of compensation advisers or advisory firms;
- subject to cure provisions, require national securities exchanges to prohibit the listing of a company that does not develop and disclose a policy for reviewing unearned bonus payments,

incentive payments, or equity payments that were awarded to executive officers due to fraud, financial results that require restatement, or some other cause and requiring recovery or cancellation of any unearned payments, to the extent that it is feasible and practical to do so;

- subject to cure provisions, require national securities exchanges to prohibit the listing of a company whose board enters into severance agreements with a senior executive officer who is terminated due to poor performance; and
- require the SEC to implement rules providing for improved disclosure of compensation targets.

As discussed above with respect to the Proposed Act, it is uncertain what, if any, of these provisions will be implemented.

We will continue to keep you informed of significant corporate governance developments as they occur. If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] For more information, see the January 2009 Stay Current entitled "Shareholder Proposals, Proxy Access and the Current Proxy Season," which can be accessed at: www.paulhastings.com/publicationDetail.aspx?PublicationId=1140.

[2] A "large accelerated filer" is generally defined in Rule 12b-2 as an issuer with an aggregate worldwide market value of voting and nonvoting common equity held by non-affiliates of $700 million or more as of the last business day of the issuer's second most recently completed fiscal quarter where certain other requirements are met.

[3] An "accelerated filer" is generally defined in Rule 12b-2 as an issuer with an aggregate worldwide market value of voting and nonvoting common equity held by non-affiliates of $75 million or more, but less than $700 million, as of the last business day of the issuer's second most recently completed fiscal quarter where certain other requirements are met.

[4] A "non-accelerated filer" is not specifically defined in Rule 12b-2, but is generally a filer that is neither a large accelerated filer nor an accelerated filer.

[5] Where 25% of the board is not a whole number, the maximum number of shareholder nominees required to be included in a company's proxy materials is the closest whole number below 25%.

[6] The SEC has proposed to amend Regulation S-T to permit Schedule 14Ns to be filed up until 10:00 p.m. ET on a given day and still receive that day's filing date; most other filings must be received by 5:30 p.m. ET to receive that day's filing date.

[7] The shareholder nominee would only have to meet the exchange's general objective standards for independence and would not be required to meet any heightened standard of independence applicable to audit committees. A shareholder nominee would not be required to represent that it meets any subjective standard of independence (*e.g.*, the NYSE has an independence standard, which, among other things, requires the board of directors to make an affirmative determination that an independent director has no "material relationship" with the subject company; a shareholder nominee would not have to represent that it meets this subjective standard).

[8] "Shareholder Proposals, Proxy Access and the Current Proxy Season," which can be accessed at the following link: www.paulhastings.com/publicationDetail.aspx?PublicationId=1140.

[9] In addition, the DGCL amendments contain technical amendments to DGCL §§ 211(c), 219(a), 222, 228(e), 262, and 275(a) to conform to the amendment to DGCL § 213(a).

[10] The SEC recently proposed rules with respect to the "say on pay" vote required to be implemented by recipients of financial assistance under the Troubled Asset Relief Program.

[11] On July 1, 2009, the SEC voted to approve a proposed rule change by the NYSE that eliminates discretionary broker voting for the election of directors, except for companies registered under the Investment Company Act.