

WSGR ALERT

SEPTEMBER 2011

SEC ELECTS NOT TO APPEAL PROXY ACCESS DECISION

Also Seeks Public Comment on Plan to Conduct Retrospective Reviews of Existing Regulations

On September 6, 2011, the Securities and Exchange Commission (SEC) announced that it would not seek either a rehearing by the Court of Appeals or an appeal to the U.S. Supreme Court of the recent decision vacating its proposed proxy access rule.¹ As proposed, the rule would have required many companies to include shareholder director nominees in their proxy materials in certain circumstances.²

In announcing the SEC's decision, Chairman Mary L. Schapiro stated that she "remains committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards." However, she also signaled that the SEC was unlikely to engage in a rewrite of the proxy access rules in the near future, as she has "asked the [SEC's] staff to continue reviewing the decision as well as the comments that [the SEC] previously received" so that the SEC may "carefully consider and learn from the [decision in order to] determine the best path forward." As a result, it is reasonable to assume that the SEC will not revisit mandatory proxy access for some time.

Notwithstanding its decision not to appeal, the SEC confirmed that the previously

proposed amendments to Rule 14a-8—the effectiveness of which had been voluntarily stayed by the SEC pending the outcome of the litigation challenging the larger proxy access rule—would become effective on September 13, 2011, "absent further [SEC] action."³ These amendments permit eligible shareholders to include proposals regarding the adoption of proxy access procedures in a company's proxy statement through the Rule 14a-8 shareholder proposal process. As the SEC stated, through "this procedure, shareholders and companies have the opportunity to establish proxy access standards on a company-by-company basis—rather than a specified standard like that contained in" the proposed proxy access rule.

In permitting "private ordering" proxy access through Rule 14a-8 to become effective, the SEC can be expected to impose a high bar on companies seeking to exclude such proposals through the Rule 14a-8 no-action process. It should be anticipated that the SEC will permit few, if any, of these proposals to be excluded unless they are clearly deficient on other Rule 14a-8 grounds (e.g., share ownership for an insufficient period of time). The SEC may view the amendments to Rule 14a-8 as a low-cost way to study the implementation and

operation of some form of proxy access in what is likely, at least initially, to be a relatively limited subset of companies.

Companies—particularly those with shareholders who have been successful in bringing and adopting Rule 14a-8 proposals or those with a history of public shareholder activism—may wish to begin the process of considering potential responses to the receipt of a Rule 14a-8 proxy access proposal. Shareholders submitting proxy access proposals through the Rule 14a-8 process are likely to seek procedures that are more permissive (and perhaps significantly so) than those proposed in the SEC's proxy access rule.⁴ As a result, it may make sense for some companies and their boards of directors, following the receipt of a proxy access shareholder proposal, to consider whether there are proxy access procedures for their company that are more appropriate than those that have been proposed by the shareholder, which proposal may be the product of the shareholder's particular agenda. However, preemptive board action in these circumstances should be the product of careful consideration because it remains to be seen how the SEC will treat a company's unilateral adoption of proxy access after

¹ Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation, available at <http://www.sec.gov/news/press/2011/2011-179.htm>.

² The rules are explained in our WSGR Alert titled "The Advent of Proxy Access: Implications for Public Companies and Boards," available at http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert_proxy_access.htm.

³ *See id.*

⁴ We expect that most shareholder proposals will likely follow ISS's ultimate recommendation on proxy access in terms of ownership threshold and tenure. ISS's current policy on proxy access is completely on a case-by-case basis, and it is presently unclear exactly what type of proxy access policy ISS will ultimately favor.

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receipt of a shareholder proposal for the purposes of Rule 14a-8's substantial implementation standard.

Simply stated, it is unclear if the SEC will consider shareholder-proposed proxy access to be substantially implemented—thereby allowing the company to exclude the proposal from its proxy statement—if a company adopts some form of proxy access where the company's version of proxy access is different from that proposed by the shareholder. It is possible that the SEC will take the position that the proposal must be submitted to a shareholder vote unless the company's procedures are very similar (e.g., identical ownership threshold and tenure) to those proposed by the shareholder. As is often the case with the Rule 14a-8 process, these issues are likely to take some time before they are finally resolved and will vary based on the particular factual circumstances.

The advent of private ordering proxy access will require companies to continue to engage with their shareholder base. In particular, it is critical that companies have a firm understanding of the level of influence that ISS's recommendations have over the company's shareholder base, as that will often determine the outcome of the vote. As we have previously suggested, companies should know the composition of their shareholder base and be aware of changes to that base. For example, what percentage of shareholders are institutional investors and what percentage are retail investors? Which institutional investors have long-term investment strategies and which have short-term strategies? Have institutional investors previously indicated an interest in implementing proxy access at portfolio companies? Understanding the composition of a company's shareholder base can help guide decisions about engaging with shareholders,

both during the year as well as during proxy solicitations. Having an ongoing relationship with a proxy solicitor can be useful here, as they can assist in these analyses.

In addition, we suggest that companies take a more comprehensive, year-round view of shareholder engagement and director elections. For example, every company should have a firm understanding of what board actions are likely to cause a proxy advisory firm such as ISS to recommend voting against a director nominee at an annual meeting. Since proxy advisory firms may recommend voting against director nominees as a result of perceived corporate governance concerns, we suggest periodically conducting a review of your company's corporate governance policies and procedures. In our view, continuous shareholder engagement is vital, and companies that only interact with their shareholders on a substantive level in connection with each year's annual meeting do so at their peril.

In short, although mandatory proxy access is not likely to be on the SEC's agenda for the foreseeable future, proxy access as a concept has not disappeared. The next few years are likely to see continued developments in the private ordering process.

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Separately, the SEC announced that it is seeking public comment on a plan to conduct retrospective reviews of its existing regulations.⁵ This includes public comment on, among other things, how often rules should be reviewed, the factors that should be considered, and ways to improve public participation in the rulemaking process. This process is an outgrowth of President Obama's July 11 executive order recommending that independent regulatory agencies consider

how they might best analyze rules that may be outmoded, ineffective, or excessively burdensome, and then modify, streamline, or repeal them.⁶ The order also recommends analysis of regulations that might need to be strengthened or modernized, which may entail new rulemaking. Further, the SEC has long had in place formal and informal processes for the review of existing rules to assess the rules' continued utility and effectiveness in light of the evolution of the securities markets and changes in the securities laws and regulatory priorities. This plan would help to further those objectives.

In addition to general comments on the scope and elements of any plan for a retrospective review of the existing significant regulations, the SEC specifically encourages comments on the following items:

- What factors should the SEC consider in selecting and prioritizing rules for review?
- How often should the SEC review existing rules?
- Should different rules be reviewed at different intervals? If so, which categories of rules should be reviewed more or less frequently, and on what basis?
- To what extent does relevant data exist that the SEC should consider in selecting and prioritizing rules for review and in reviewing rules, and how should the SEC assess such data in these processes? To what extent should these processes include reviewing financial economic literature or conducting empirical studies? How can the SEC's review processes obtain and consider data and analyses that address the benefits of the

⁵ "SEC to Seek Comment on Review of Existing Regulations," available at <http://www.sec.gov/news/press/2011/2011-178.htm>.

⁶ "Executive Order—Regulation and Independent Regulatory Agencies," available at <http://www.whitehouse.gov/the-press-office/2011/07/11/executive-order-regulation-and-independent-regulatory-agencies>; see also our WSGR Alert titled "Court Vacates SEC's Proxy Access Rules," available at <http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-proxy-access-rules.htm>.

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SEC's rules in preventing fraud or other harms to the financial markets and in otherwise protecting investors?

- What can the SEC do to modify, streamline, or expand its regulatory review processes?
- How should the SEC improve public outreach and increase public participation in the rulemaking process?
- Is there any other information that the SEC should consider in developing and implementing a preliminary plan for retrospective review of regulations?

Please note that at this time the SEC is only seeking public comment on the development of its plan for retrospective review, not on specific rules.

Public comments are due by October 6, 2011, and may be submitted through the SEC's website at <http://www.sec.gov>.

For any questions or more information on these or related matters, please contact your regular Wilson Sonsini Goodrich & Rosati contact or any member of the firm's corporate and securities or securities litigation practices.



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