

SEC Adopts New Proxy Access Rule

By Hilary Russ

Law360, New York (August 25, 2010) -- The U.S. Securities and Exchange Commission has voted to adopt a proxy access rule that allows long-standing shareholders in a company to list nominees for the corporate board directly on voting materials.

Commissioners voted 3-2 on Wednesday along party lines for the controversial new measure, which is expected to make it easier for certain shareholders to get their candidates onto boards and replace directors they don't like.

Activist and institutional shareholders have sought such access in part because it spares them the expense of creating their own mailings to oust directors. SEC Chairwoman Mary Schapiro said the measure had been debated for three decades.

"As a matter of fairness and accountability, long-term significant shareholders should have a means of nominating candidates to the boards of the companies that they own — candidates that all shareholder-voters may then consider alongside those who are nominated by the incumbent board," Schapiro said at Wednesday's hearing.

"The critical point is that shareholders have the ability to make this choice," she said.

But Republican Commissioner Kathleen Casey blasted the rule, saying that it would harm the economy and was "so fundamentally and fatally flawed that it will have great difficulty surviving judicial scrutiny."

Business groups also trounced the rule, saying it would handicap average investors and give special interests an unfair advantage in corporate elections.

"Using the proxy process to give labor union pension funds and others greater leverage to try to ram through their agenda makes no sense," said David Hirschmann, president and CEO of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness.

"Instead of giving some investors front-of-the-line passes, the SEC should be focused on advancing the interests of all investors, including retail investors," Hirschmann said. "The Chamber ... will continue to fight this flawed approach using every method available."

Schapiro acknowledged that the process created by the proxy access rule would be a "marked change to the status quo," adding that she was "committed to closely monitoring how these new rules are implemented."

The new rule applies to a shareholder or group of investors who have continually owned at least 3 percent of a company's voting stock for at least three years. The final rule includes details on how to calculate the percentage amount, Schapiro said.

To hit that critical amount, shareholders may not borrow stock, although they may count stock that they own but have loaned to others under certain conditions.

For the smallest public companies, the rule will be postponed for three years while the SEC monitors how the measure is implemented at larger companies, Schapiro said.

Securities attorneys said that over the past five years, shareholders of public companies have acquired an increasing array of tools to get their voices heard.

"Proxy access is the latest leverage point that shareholders can use to get the attention of boards," said Patrick G. Quick, a partner in Foley & Lardner LLP's transactional and securities practice.

"It will be interesting to see how much activists are able to use the mere threat of the rule as a bargaining chip to influence director nominees or other corporate governance matters," Quick said.

"I expect this rule will lead to greater compromise between shareholders and companies on director nominees or other shareholder issues such that shareholders ultimately do not use the process," he said.

Jim Allen, head of capital markets policy for the CFA Institute, also predicted that use of the proxy access rule would be used only on rare occasions.

"We only see this being used in cases of the most egregious governance or board failures because of the difficulty and cost involved in getting a shareowner nominee elected to the board," Allen said.

Sanjay Shirodkar, of counsel at DLA Piper, said that the 3 percent, three-year stipulation set a fairly high threshold for most public companies.

"While it is not clear, it is likely that this rule will have a greater impact on middle-market companies where institutional and individual investors tend to hold a larger percentage of the outstanding shares by themselves," Shirodkar said.

Russell D. Duncan, a partner at Orrick Herrington & Sutcliffe LLP, doubted the ability of challengers to get the new rule thrown out in court because the SEC's vote came after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which specifically called for action on the issue and confirmed the agency's authority over proxy access.

"Although styled as a populist-like shareholders' access rule, it is more properly viewed as a 'shareholder,' singular, access rule," Duncan said.

"Few individuals or entities are likely to own 3 percent of a company for three years," he said. "Thus, the rule actually may permit a single shareholder to have a significant impact, and potentially self-interested impact, on a company's corporate governance to the exclusion of all other shareholders."