

SEC PROXY PROPOSALS COULD PUT COMPANIES ON AN UNANTICIPATED DEFENSIVE

The focus of the Securities and Exchange Commission's (SEC's) recent proposals to amend the proxy rules, and much of the commentary relating to them, has been on executive compensation disclosure and management of risk. However, the SEC has also proposed and is seeking comment on several rule amendments that fundamentally could alter the solicitation process and stockholders' voting.

Significantly, proposed changes to the "short slate" rules (where a person solicits support for nominees who, if elected, would constitute a minority of the board of directors) could potentially encourage shareholders to run more slates by permitting a soliciting person to round out its short slate with other persons' nominees instead of or in addition to a company's nominees. As proposed, this could lead to a change in a majority of a board—a risk that may increase if shareholders gain access to a company's proxy materials for shareholder nominations.

In addition, proposed changes to the proxy rules would allow shareholder activists to mail a duplicate unmarked copy of management's proxy card to shareholders, with a direction to return the card to management, without having to incur the costs of a fully-regulated proxy solicitation. Other proposals would modify the proxy solicitation process.

Comments are due on September 15, 2009. We expect that new rules will be adopted by the SEC soon thereafter and in time for the 2010 proxy season.

A companion advisory discusses how the SEC's proposals affect executive compensation disclosure and management of risk.¹

Below we summarize the aspects of the SEC's proxy rule proposals that could put companies on the defensive, which are areas where companies may wish to comment.

A Proposed Amendment May Give Shareholders Running a Short Slate Greater Ability to Influence Board Composition or Effect a Change in Control. The SEC's proposed amendments would provide that a person soliciting in support of nominees who, if elected, would constitute a minority of the board (a "short slate") may seek authority to vote for another soliciting person's nominees in addition to or

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¹ See "Current Environment Brings New Governance Challenges—SEC Proposes Enhanced Compensation and Governance Disclosures and Increases Emphasis on Risk Management and Board Oversight," available at: http://www.arnoldporter.com/public_document.cfm?id=14647&key=12H3.

instead of the company's nominees to round out its short slate. The current SEC rule expressly permits rounding out a short slate by seeking authority to vote for nominees named in the company's proxy statement, but does not address nominees named in other soliciting persons' proxy statements. This proposed change would codify a position that the SEC has taken in two no-action letters issued in 2009.²

The proposed exception would be available only when non-management parties are not acting together. A non-management soliciting person that seeks to round out its short slate with any nominee named in another non-management person's proxy statement would be required to represent in its proxy statement that it has not agreed and will not agree to act, directly or indirectly, as a group or otherwise engage in any activities that would be deemed to cause the formation of a group with the other non-management person.

Although the proposed amendment would prevent shareholders from acting in concert, the proposed amendment could potentially encourage shareholders to run more slates, possibly targeting particular companies, knowing that other shareholders may also run short slates for that company, and that each shareholder could then round out its own short slate with one or more nominees from the other shareholder's slate.

In addition, it is possible that permitting a soliciting person to round out its short slate with other persons' nominees instead of or in addition to a company's nominees, as proposed, could lead to a change in a majority of a board. A change in a majority of the board could in turn lead to a number of possible effects, including the triggering of poison pills and other change-in-control provisions. Companies may want to consider revising their poison pills or other change-in-control provisions in light of this proposal.

² See Eastbourne Capital, L.L.C., SEC No-Action Letter (Mar. 30, 2009) and Icahn Associates Corp., SEC No-Action Letter (Mar. 30, 2009) at <http://www.sec.gov/divisions/corpfin/cf-noaction.shtml>. Although the SEC Division of Corporation Finance would consider continuing to issue such letters in the absence of adoption of the proposed amendment, only the parties to whom no-action letters are addressed can rely upon them.

Under a Proposed Amendment to the Proxy Solicitation Rules, “Vote No” Campaigns Could Increase and Have a Higher Success Rate. Under Rule 14a-2(b)(1) of the proxy rules, solicitations by shareholders or other non-management parties who do not seek proxy authority and do not have a substantial interest in the subject matter of the solicitation are exempt from the disclosure, filing, and other requirements of the proxy rules. However, this exemption is unavailable to a person who furnishes or otherwise requests a “form of revocation.” A proposed amendment to the proxy solicitation rules would provide that an unmarked copy of management's proxy card that is requested to be returned directly to management is not a “form of revocation,” even though the return of the proxy card may in fact supersede a prior vote.

This proposed change could result in an increase in “vote no” campaigns and a greater likelihood of their success. Shareholder activists running a “vote no” campaign frequently mail a duplicate unmarked copy of management's proxy card to shareholders and then request that the card be returned directly to management. If the proposed amendment is adopted, a person who furnishes such a duplicate proxy card would not be providing a “form of revocation” and would therefore not be disqualified from relying on the exemption from proxy disclosure, filing, and other requirements. The proposing release notes that the amendment would aid efforts by persons running “vote no” campaigns without their “having to incur the costs and efforts of conducting a fully-regulated proxy solicitation.”

Additional Changes to the Proxy Solicitation Rules. The SEC is proposing three additional changes to the proxy solicitation rules.

- The Rule 14a-2(b)(1) exemption from certain proxy rules is not available to “[a]ny person who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities, other than a benefit arising from the person's employment with the registrant.” In a tightening of the current rule, the SEC proposes to amend

the exemption to clarify that a person need not be a security holder of the class of securities being solicited, and a benefit need not be related to or derived from security holdings in the class being solicited, for a person to be disqualified from relying on the exemption.

- A proposed amendment would provide that the “reasonable specified conditions” under which the shares represented by a proxy will not be voted must be “objectively determinable.” The proposing release states that if such reasonable specified conditions were not objectively determinable, the recipient of a proxy could seek to exercise a degree of discretion that would be inconsistent with Rule 14a-4’s limits on when a proxy can confer discretionary authority.
- Finally, the SEC proposes to amend Rule 14a-12 to clarify that participant information must be filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials no later than the time the first soliciting communication is made.

We hope you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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