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CORPORATE AND SECURITIES LAW
Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Proxy Access and Shareholder Activism: What to Do Now?

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We are being asked by our public company clients what they should do now in light of the SEC's proposed rules mandating proxy access, recent amendments to the Delaware General Corporation Law enabling proxy access (to be effective on August 1 of this year), and the SEC's recent approval of rules eliminating broker discretionary voting in connection with uncontested board elections (to be effective for meetings held on or after January 1, 2010). For background regarding these developments, see our previous Corporate and Securities Law Alerts dated July 1, June 15 and May 15.

While there is no one-size-fits-all approach to these developments, we believe that there are certain considerations public companies should take into account in this interim period before any final SEC rules related to proxy access are adopted.

Wait-and-See Approach. Although some commentators have advocated otherwise, we generally believe it premature for public companies to adopt proxy access-related amendments to their bylaws in advance of the adoption of final SEC proxy access rules. Because of the uncertainty regarding what will be included in the final rules and when such rules would be effective (comments are due on the proposed rules by August 17), any endeavor to amend a public company's bylaws in advance of the adoption of final SEC rules runs a significant risk that company time and expense will be wasted on bylaw amendments that will need to be revised again, perhaps materially, based on what is included in the final rules.

Possible Scenarios. Public companies should consider various scenarios regarding what will be included in the final SEC rules, such as:

- The SEC adopts final rules which, consistent with the proposed rules, (1) mandate proxy access under new Rule 14a-11, and (2) amend Rule 14a-8 to require public companies to include shareholder proposals in company proxy materials that would amend or propose to amend the company’s governing documents to provide for less restrictive proxy access rules and procedures than those required under the SEC's rules. In this event, a board of directors will likely need to amend its company’s bylaws to take into account the new proxy access rules, but will have little or no flexibility to determine the parameters of proxy access for the

company (except to the extent that the board desires to include less restrictive proxy access provisions than mandated by SEC rules).

- The SEC adopts final rules which (1) do not prescribe proxy access rules for public companies, as currently contemplated by proposed Rule 14a-11, and (2) amend Rule 14a-8 to require public companies to include shareholder proposals in company proxy materials that would amend or propose to amend the company's governing documents to provide for proxy access rules and procedures (or, alternatively, the SEC adopts Rule 14a-8 for the 2010 proxy season and defers the effective time of Rule 14a-11 to some later time). In this scenario, a board of directors will want to consider amending its company's bylaws to provide for proxy access to preempt shareholders from proposing bylaw amendments related to proxy access that may be less company-friendly than those approved by the board. Currently, the available precedent for proxy access bylaws is limited, although the American Bar Association Taskforce on Shareholder Proposals recently circulated a thoughtful and comprehensive draft of a model proxy access bylaw with commentary (RiskMetrics Group, Inc. also has a proxy access provision in its public company bylaws).

Rule 452 and Majority Voting. As discussed in our July 1 alert, the impact of the Rule 452 amendment, which will eliminate broker discretionary voting in connection with uncontested elections of directors for all public companies (other than investment companies), will be significant for companies whose shareholder base has a significant retail component (typically, a significant majority of retail votes are not voted unless prompted by active solicitation efforts). Companies that have majority (or plurality-plus-resignation) voting will be particularly susceptible to the effects of this change, as the anticipated reduction in the size of the retail vote will increase the difficulty of incumbent directors receiving the requisite majority vote. For this reason, many companies that have not switched to majority (or plurality-plus-resignation) voting should be cautious about doing so in the current environment.

Companies that have majority (or plurality-plus-resignation) voting should review their organizational documents now regarding the impact of the Rule 452 amendment on their majority voting provisions. Although varying formulations of majority voting have been adopted by companies, as a general matter, companies will want to make sure that their organizational documents provide that broker non-votes (that is, when a broker has not received voting instructions from the beneficial owner of shares and therefore does not vote) in connection with uncontested elections of directors will have a neutral impact rather than a negative impact on the ability of directors to receive a majority vote.

Second Generation Advance Notice Bylaw Provisions. In the event that a board makes a determination to amend a company's bylaws later this year in connection with the SEC's adoption of final rules or other developments, boards will want to consider (to the extent they have not already taken this action) using this amendment process as an opportunity to make further amendments to their company's bylaws to incorporate "second generation" advance notice bylaw provisions adopted by many U.S. public companies in 2008 in response to Delaware court decisions in early 2008 interpreting advance notice bylaw provisions narrowly in favor of dissident shareholders. It is unclear whether these or any other advance notice bylaw provisions will be enforceable in connection with Rule 14a-11 nominations made by

shareholders under the new SEC rules. However, even if the final SEC rules do not allow companies to impose any advance notice bylaw restrictions on Rule 14a-11 nominations, these second generation advance notice bylaws will apply to shareholder nominations or proposals made outside of the scope of Rule 14a-8 or Rule 14a-11, respectively (that is, to shareholder nominations or proposals included in a dissident's own proxy statement).

Vacancies. Companies that have any vacancies on their board should consider filling vacancies sooner rather than later. In the event proxy access becomes applicable to public companies for the 2010 proxy season, it will generally be preferable for companies to have an incumbent director running for this previously-vacated seat rather than a recently-appointed director or a new nominee.

Final Thoughts. Although it is unclear what will be included in the final SEC rules, it is apparent that the era of routine director elections is over for many U.S. public companies. Whether the SEC mandates proxy access or a private-ordering approach (that is, through the SEC's adoption of the Rule 14a-8 amendment in conjunction with the recently adopted Delaware legislation facilitating the adoption of proxy access bylaws) is followed, we believe that the implementation of proxy access will increase the number of U.S. public companies that become subject to contested director elections, including multi-shareholder contests. Moreover, irrespective of what proxy access regime is adopted, the SEC's elimination of broker discretionary voting in connection with uncontested elections of directors is likely to diminish the influence of retail voters and further empower institutional and activist shareholders and proxy advisory services such as RiskMetrics, Glass Lewis and Proxy Governance.

In this environment, it is particularly important for public companies to monitor their shareholder base and to maintain communications with significant shareholders. In addition, public companies are advised to review their structural defenses and organizational documents in connection with these developments. The importance of undertaking this review is heightened by the fact that unsolicited and hostile takeover activity has recently increased and is expected to continue to be prevalent in the United States during the remainder of 2009.

Bass, Berry & Sims PLC's Shareholder Activism Subgroup monitors and advises on developments in the area of proxy contests, activist campaigns, takeover defenses and shareholder communications. If you have any questions regarding the issues addressed in this Corporate and Securities Law Alert or if you would like to set up a meeting with us and your management team or board of directors regarding these developments, please feel free to contact you regular contacts in our Corporate and Securities Group or any of the attorneys in our Shareholder Activism Subgroup listed below.

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Bass, Berry & Sims PLC Corporate and Securities Group

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