

SEC proxy access rules give eligible shareholders access to company proxy statements

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In a release published Aug. 25,¹ the Securities and Exchange Commission adopted changes to the federal proxy rules that will provide eligible shareholders with access to company proxy materials for the purpose of nominating candidates for election to the board of directors. The new rules were facilitated by the recent passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provides the SEC with a broad legislative mandate to adopt rules giving shareholders access to company proxy materials to nominate director candidates.

It is worth noting that two of the five SEC commissioners dissented from adoption of the new rules, leading many experts to predict that litigation challenging the new rules will ensue, despite the fact that the Wall Street Reform Act mandated adoption of proxy access rules.

The new proxy access rules borrow heavily (with some significant changes) from controversial rules proposed but not adopted by the SEC in 2009. As with the last round of proposals, the new rules contain two key components:

- New Rule 14a-11, providing for mandatory access to company proxy statements and cards for shareholders with a “long-term interest and commitment” in the company to nominate a limited number of director candidates.
- Amendments to Rule 14a-8(i)(8) that narrow the “election exclusion” for shareholder proposals relating to individual director elections and terms in office.

NAVIGATING THE NEW RULES

The SEC’s mammoth 451-page release notes that proxy regulation was one of the original tasks with which the agency was charged by Congress at the time of the adoption of the Securities Exchange Act of 1934. In its earlier proposals, the SEC highlighted its concern that the federal proxy rules may not enable shareholders to exercise fully their state law

rights to nominate director candidates. The SEC considers this a “failure of the proxy process” that has a “practical effect” on the right of shareholders to nominate and elect directors.

Accordingly, the SEC said in the release, the new rules “will benefit shareholders by

improving corporate suffrage, the disclosure provided in connection with corporate proxy solicitations and communication between shareholders in the proxy process,” which in turn “will significantly enhance the confidence of shareholders who link the recent financial crisis to a lack of responsiveness of some boards to shareholder interests.”

Requirements applicable to nominating shareholders

Eligibility requirements	<u>Minimum beneficial ownership threshold</u> • 3 percent of the voting power of company’s shares. • Shares loaned to a third party may be included <i>only</i> if the shareholder has the right to recall the loaned shares and will recall the loaned shares upon being notified that any of its nominees will be included in company’s proxy materials. • Shares sold short and borrowed shares may not be included. <u>Aggregation</u> • To meet eligibility requirements, shareholders are entitled to aggregate their holdings. <u>Duration of ownership</u> • Continuous ownership (if applicable, by <i>each</i> group member) of the requisite amount of shares for at least three years. • Demonstrated intent to continue to own such shares <i>until</i> the applicable shareholders meeting. • Shareholders must provide disclosure concerning their intent with regard to continued ownership of the shares after the applicable shareholders meeting.
Loss of eligibility	• If nominating shareholder or any nominating group member submits any other nomination or participates in another group. • If nominating shareholder or any nominating group member separately conducts a solicitation in connection with the subject election or acts as a participant in another’s solicitation.

Notice requirements	<u>New Schedule 14N</u>: Provide notice to company and the SEC on Schedule 14N of intent to require inclusion of nominee(s) in proxy materials (and promptly amend for any material change).⁶ <u>Deadline for notice</u>: No earlier than 150 calendar days and no later than 120 calendar days (or if such date is a Saturday, Sunday or holiday, the next business day) prior to the anniversary of the mailing of the prior year's proxy statement.⁷ If a company did not hold an annual meeting during the prior year, or if the date of the meeting has changed by more than 30 calendar days from the date of the prior year's meeting, the company is required to file a Form 8-K disclosing the date by which the notice must be submitted, which date shall be "a reasonable time before the registrant mails its proxy materials for the meeting."⁸ <u>Schedule 14N disclosures</u> • Name and address of nominating shareholder or each member of the nominating shareholder group, as applicable. • Amount of shares held by each reporting person that are entitled to be voted on the election of directors. • That the minimum share ownership and duration of share ownership requirements are satisfied. • That, to the knowledge of the nominating shareholder or group, nominee(s) satisfies company's director qualifications, if any, as provided in company's governing documents. • Statement from the nominee(s) consenting to being named in the proxy statement and to serving on the board if elected. • Statement that nominating shareholder(s) intend to continue to own requisite shares through the date of the applicable shareholders meeting and regarding nominating shareholder(s) intent with respect to continued ownership after the election. • Certification that, to the knowledge of nominating shareholder(s), shares are not held for the purpose or with the effect of changing control of company or gaining a number of seats on the board of directors that exceeds the maximum number of nominees the company is required to include. • Various disclosures about the nominating shareholder(s) and the nominee(s) consistent with disclosures currently required under the proxy rules in a contested election. • Disclosure about the nature and extent of the relationships among the nominating shareholder or group, the nominee(s) and/or company or any affiliate of company. • Disclosure regarding whether the nominating shareholder or any group member has been involved in any legal proceedings during the past 10 years. • Disclosure of any website to be used by the nominating shareholder for publication of soliciting materials in support of its nominee(s). • If desired, a statement in support of the nominee(s), not to exceed 500 words.⁹
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The new rules will become effective Nov. 15. Accordingly, they will be operative for most companies in connection with the 2011 proxy season.² For any company that qualifies as a smaller reporting company³ under the Exchange Act, however, application of the new rules will be deferred for three years in order to provide the SEC "with the additional opportunity," as required by the Wall Street Reform Act, "to consider whether adjustments to the rule would be appropriate

for smaller reporting companies before the rule becomes applicable to them," the release said.

NEW RULE 14A-11

New Rule 14a-11 provides holders of "a significant, long term stake in a company" with the right, under certain circumstances, to include their nominees for election as directors in the company's proxy materials in connection with annual shareholders

meetings (or a special meeting held in lieu of an annual meeting).⁴

As noted in the release, "Rule 14a-11 will apply only when applicable state law or a company's governing documents do not prohibit shareholders from nominating a candidate for election as a director."⁵ On the other hand, companies will not be permitted to opt out of the requirements of the rule or adopt more restrictive access rules.

Notably, the new rule is not available to shareholders who seek to change control of a board or gain more than a limited number of seats. Rather, in those instances, the procedures currently available under Rule 14a-12(c) for waging a proxy contest continue to apply.

"The new rules will benefit shareholders by improving corporate suffrage [and] the disclosure provided in connection with corporate proxy solicitations," the SEC said.

Requirements applicable to nominees

Independence requirements	Nominees must satisfy “objective” independence requirements of the national securities exchange (if any) on which the company’s shares are traded.¹⁰
Company exclusion of shareholder nominees	Company will not be required to include a shareholder nominee if: - Nominee’s candidacy or, if elected, board membership would violate controlling state or foreign law, the rules of a national securities exchange (other than its subjective independence requirements), or company’s governing documents. - Nominating shareholder or group does not satisfy the eligibility requirements of Rule 14a-11. - Including the nominee(s) would result in the company’s exceeding the maximum number of nominees it is required to include under Rule 14a-11. - Any information required in the Schedule 14N notice either is omitted or is false or misleading in any material respect, including information as to whether the nominee satisfies the applicable “objective” securities exchange independence requirements.

Requirements applicable to companies

Subject companies	All companies subject to the SEC’s proxy rules (except debt-only issuers), including voluntary filers.
Number of nominees	- The company will not be required to include more than one shareholder nominee or a number of nominees representing up to 25 percent of the board, whichever is greater. - Maximum number includes any nominees the company voluntarily agrees to include on company’s slate <i>after</i> being named on a filing on Schedule 14N. - In calculating this maximum amount, any shareholder-nominated director elected at a previous meeting whose term extends beyond the meeting in question would be counted (<i>i.e.</i>, a staggered board). - If 25 percent of the board is not a whole number, the maximum number of shareholder nominees will be the closest whole number <i>below</i> 25 percent. - If the company’s board is staggered, the 25 percent calculation is based on the total number of board seats.
Multiple nominating shareholders	In the event there are multiple eligible nominating shareholders, the nominating shareholder or group representing the highest percentage of the company’s voting power would have its nominees included in company’s proxy materials. ¹¹
Company voting guidelines and recommendations	- The company will be permitted, on its proxy card, to identify any shareholder nominees as such and to include a recommendation as to how shareholders should vote (for, against or withhold). - However, when a shareholder nominee is included on its proxy card, the company will no longer be permitted to provide shareholders with the option of voting for all company nominees as a group; rather, each company and shareholder nominee will be voted on separately.
Notification requirements	- The company must notify nominating shareholder(s) within <i>14 calendar days</i> of any objections. The nominating shareholder(s) in turn will have <i>14 calendar days</i> to respond with corrections, <i>provided</i> that neither the composition of a shareholder group nor a nominee may be changed. - No later than <i>80 calendar days</i> before filing its definitive proxy materials, the company must notify the SEC if it determines that it <i>may</i> exclude any nominee and provide a supporting opinion of counsel. - The company may seek informal no-action advice from the SEC. - A notice of the company’s decision to include any nominee must be given to nominating shareholder(s) no later than <i>30 calendar days</i> before the filing of definitive proxy materials.

Companies will not be permitted to opt out of the requirements of the rule or adopt more restrictive access rules.

AMENDMENT TO RULE 14A-8

As amended in 2007, Rule 14a-8(i)(8) (also known as the “election exclusion”) permits a company to exclude from proxy materials any shareholder proposal relating to the nomination or election of board members.¹² The newly adopted amendment to Rule 14a-8(i)(8) reverses the 2007 amendments, thus enabling shareholders to require the inclusion in company proxy materials of proposals to amend (or to request an amendment of) the company’s governing documents regarding

nomination procedures or disclosures related to shareholder nominations, so long as the proposal would not put greater restrictions on proxy access than are set forth in Rule 14a-11 or:

- Disqualify a particular nominee;
- Remove a particular director mid-term;
- Question the “competence, business judgment or character” of any particular nominee or director;
- Seek to include a specific nominee in the company’s proxy materials; or
- “Otherwise could affect the outcome of the upcoming election of directors.”

It should be noted that Rule 14a-8 requires that a shareholder making a proposal for inclusion in the proxy materials must have continuously held at least \$2,000 in market value, or 1 percent of the company’s voting shares for a period of one year prior to

submitting the proposal. The amendments do not change this requirement.

SCHEDULES 13D AND 13G

The SEC has adopted a new exception to its beneficial ownership reporting rules for 5 percent shareholders that permits reporting on Schedule 13G, rather than the more detailed Schedule 13D, for shareholders or groups that engage in activities in connection with a nomination under new Rule 14a-11. However, this exception does not apply to nominating shareholders or groups that submit a nomination pursuant to an applicable state law provision or a company’s governing documents (as opposed to Rule 14a-11 itself).

EXCHANGE ACT SECTION 16

Current Section 16 principles continue to be applicable for determining whether

Other key aspects of the new rules

No preliminary proxy materials	Rule 14a-6 is amended to provide that company will <i>not</i> be required to file preliminary proxy materials solely because of the inclusion of shareholder nominees pursuant to Rule 14a-11, even if opposed by the company.
Exemptions for communications and solicitations	For written and oral solicitations by shareholders seeking to form a nominating shareholder group, if: • Shares are not held for the purpose or with the effect of changing control of issuer or gaining a number of seats on the board of directors that exceeds the maximum number of nominees allowable. • All written soliciting materials sent to shareholders and, in the case of oral communications, a Schedule 14N cover page are concurrently filed with the SEC. • The nominating shareholder does not subsequently engage in “soliciting or other nominating activities” outside the scope of Rule 14a-11 in connection with the subject election. For written and oral solicitations by a nominating shareholder or group in support of nominee(s) the company has advised will be included in company’s proxy materials, if: • Nominating shareholder or group does not seek the power to act as a proxy for another shareholder. • All written soliciting materials sent to shareholders are concurrently filed with the SEC. • The nominating shareholder does not subsequently engage in “soliciting or other nominating activities” outside the scope of Rule 14a-11 in connection with the subject election.
Nominating shareholder liability	The nominating shareholder or group will be liable for any statement made in a Schedule 14N that is false or misleading regarding any material fact, or that omits any material facts necessary to make the statement not false or misleading, <i>regardless of whether that information is included in the company’s proxy statement</i> . The company will not be responsible for such disclosure.
Incorporation by reference	Information included in company proxy statement from Schedule 14N will <i>not</i> be incorporated by reference into company’s other SEC filings that incorporate the proxy statement generally.

nominating group members are 10 percent owners subject to Section 16 reporting and short-swing trading liability. **WJ**

NOTES

¹ See Securities and Exchange Commission, Release No. 33-9136, "Facilitating Shareholder Director Nominations" (Aug. 25, 2010), available at <http://sec.gov/rules/final/2010/33-9136.pdf>.

² Generally, any company whose 2011 annual meeting falls at least 120 days after the effective date.

³ Companies having less than \$75 million in public float.

⁴ According to the release, the SEC is "not aware of any law in any state ... that currently prohibits shareholders from nominating directors." In anticipation of the SEC's adopting a proxy access rule, Delaware adopted amendments to its General Corporation Law, effective Aug. 1, 2009, that create a mechanism for companies to include shareholder-nominated directors in their proxy materials.

⁵ Similarly, the rule will apply to foreign private issuers that are subject to the federal proxy rules only if applicable foreign law does not prohibit shareholders from making nominations.

⁶ Also, a final amendment would be required, within 10 days following announcement of the election results, disclosing the intention of the nominating shareholder or group with respect to continued ownership of their shares.

⁷ The deadline for submitting nominees in connection with the next year's annual meeting must be included in the prior year's proxy statement.

⁸ Pursuant to new Item 5.08, Form 8-K would be due "within four business days after the registrant determines the anticipated meeting date."

⁹ Counted as currently provided in Rule 14a-8 for other shareholder proposals.

¹⁰ Any rule requiring a "subjective determination," and more rigorous standards applicable

to audit committee members or imposed in a company's governing documents or otherwise, do not have to be satisfied.

¹¹ This replaces the proposed "first-in" method, which would have required the company to include those nominees of the first nominating shareholder or group to give timely notice.

¹² This rule was amended following *AFSCME v. AIG*, 462 F.3d 121 (2d Cir. 2006).



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