

## Corporate Finance and Securities Client Service Group

To: Our Clients and Friends

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### SEC Publishes Proposed Rules Allowing Shareholder Access to Company Proxy Materials

On June 10, 2009, the Securities and Exchange Commission (the "SEC") published the proposed new rules that would, under certain circumstances, require companies to include in their proxy materials nominations for election as directors submitted by eligible shareholders. As reported in our [May 21 Client Bulletin](#), the proposal was adopted by a divided 3-2 vote at an SEC open meeting.

The proposed rules would apply to all SEC-reporting companies (other than companies which have only publicly-issued debt), including investment companies - except where state law or governing documents prohibit shareholders from nominating a candidate for director. If the rules are adopted, a shareholder who meets specified eligibility requirements would have the right to require the company to include director nominees in the company's proxy materials, subject to limited conditions.

The SEC invites interested persons to submit comments on the proposals on or before August 17, 2009. The complete text of the proposals can be found at [SEC Proposed Proxy Access Rules](#).

#### Background

The ability of shareholders to utilize the proxy rules for purposes of nominating directors has been a focus of the SEC for many decades. The proposed rules are the latest in a series that began in October 2003. Since then, the SEC has considered the issue on four occasions and conducted a number of forums to solicit input from public companies, investors and commentators.

Three of the five Commissioners believe that that the recent economic crisis has raised questions about the accountability and responsiveness of boards of directors, and their oversight of management, including executive compensation and risk management. They believe that facilitating the ability of shareholders to exercise their rights under state law to nominate directors will enhance director accountability.

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In considering the proposed rules, the SEC evaluated existing alternatives for dissatisfied shareholders to effect changes to a company's board, including proxy contests, Rule 14a-8 shareholder proposals and "withhold vote" or "vote no" campaigns. Ultimately, the SEC concluded that these alternatives have drawbacks that limit their effectiveness. In addition, the SEC considered recent Sarbanes-Oxley reforms and state corporate law changes, but believes that federal proxy rules should nonetheless be revised to enhance the exercise of shareholder nomination rights.

The SEC did note opposing views, including the following:

- shareholder nominated directors may be beholden or focus solely on concerns of the nominating shareholder;
- such directors could disrupt the functioning of boards or lead companies in a direction that does not reflect the interests of shareholders overall; and
- the possibility of contested elections could deter qualified candidates from seeking to serve as directors.

As noted in our May 21 Client Bulletin, two of the Commissioners discussed a number of reasons for their strong opposition to the proposals at the SEC meeting.

### **New Rule 14a-11**

Under proposed Rule 14a-11, eligible shareholders would be able to require a company to include one or more nominees in the company's proxy materials, unless shareholders are otherwise prohibited from nominating a candidate for election as a director under applicable state law or the company's charter or bylaws. A company would only be required to include up to the greater of (x) 25% of the company's directors (rounding down to the closest whole number) or (y) one nominee. If one or more directors currently serving on the board was elected pursuant to the rule, and his or her term extends past the next annual meeting, that director(s) would be included for purposes of computing the maximum - thereby reducing the potential for the rule to cause a change in a larger percentage of directors.

If a company receives more nominations than required to be included, the company would only be required to include the first validly submitted nominees. (The SEC considered but opted against a standard favoring the largest shareholder or group).

Unlike earlier SEC proposals, the proposal does not require a triggering event in order for the rule to become available, such as the receipt of significant withhold votes against a director, or the failure of a company to adopt a shareholder nomination procedure that was approved by a majority vote by shareholders.

*Eligible Shareholders.* To be eligible, the nominating shareholder or group would be required to

- own a specified percentage of outstanding shares, as set forth below;
- have held those shares for at least one year;

- represent that they intend to continue to own those shares through the shareholder meeting; and
- certify they are not holding their stock for the purpose of changing control of the company or to gain more than minority representation on the board of directors.

Although the nominating shareholder must represent the absence of any control intent, the staff noted during the SEC meeting that the nominating shareholder would not be restricted from seeking control in the future. As a result, a nominating shareholder would be free to change its mind.

A change in control is not defined by the proposed rules; instead, Schedule 14N contains a required certification that the nominating shareholder does not hold the company's shares for the purpose or with the effect of changing control of the company or to gain more than a limited number of seats on the board. The first portion of this certification mirrors the corresponding language in Schedule 13G.

The applicable ownership thresholds are based on company size, as follows:

- 1% in the case of "large accelerated filers" (generally companies with a worldwide market value of \$700 million or more)
- 3% in the case of "accelerated filers" (generally companies with a worldwide market value of at least \$75 million but less than \$700 million)
- 5% in the case of a non-accelerated filer (generally companies with a worldwide market value of less than \$75 million)

*Eligible Nominees* Eligible nominees to the board of directors would be required to meet the following criteria:

- the nominee's candidacy and, if elected, board membership, must be consistent with applicable laws;
- the nominee must satisfy the objective independence standards of the applicable stock exchange on which the company is listed; and
- the nominating shareholder (or group) may not have any direct or indirect agreement with the company regarding the nomination of the nominee.

As proposed, the nominee need only meet the "objective" standards for independence under stock exchange rules, and not any subjective determinations or any particular definition applicable to audit committee members. Further, as proposed, the nominee need not meet a company's own director independence criteria. Since the candidate is the nominee of the shareholder and not the company, the SEC believes the nominee should not need to meet the board's criteria.

Additionally, the SEC considered but decided not to propose a limitation on other relationships between a nominating shareholder and the nominee, noting that, once elected, the director would be subject to state law fiduciary duties and owe the same duty to the company as other directors.

Companies that have adopted additional eligibility criteria in their charter or bylaws may want to consider their impact in light of the proposed rules.

*Required Notice and Disclosure.* The nominating shareholder would be required to notify the company of its intent to nominate a candidate, and file the notice with the SEC on new Schedule 14N. The new schedule would include:

- the name and address of the nominating shareholder or each member of the group;
- the number and percentage of shares owned by the nominating shareholder;
- the length of ownership;
- verification of ownership by the “record” owner;
- a representation of intent to continue to hold the shares through the date of the shareholder meeting;
- disclosure of intent with respect to continued ownership after the election;
- a certification regarding the lack of intent to change control or to gain more than a limited number of seats on the board of directors;
- information regarding the nominating shareholder and the nominees, including
  - representations as to the eligibility of the nominating shareholder to submit the nominee and as to the eligibility of the nominee(s) under the criteria set forth above;
  - the consent of the nominee to being named in the proxy statement and agreeing to serve, if elected;
  - disclosure comparable to that in a proxy contest, including with respect to certain legal proceedings, if any, related to the nominee, certain of the nominee’s transactions and relationships with the company, and biographical information and disclosure of certain interests of the nominee;
- any website address on which the nominating shareholder may publish soliciting materials; and
- a statement in support of the nominee(s), which may not exceed 500 words.

The 14N would also be used for disclosure of shareholder nominees when included in company proxy materials pursuant to applicable state law or a company’s governing documents, pursuant to proposed Rule 14a-19.

The SEC considered but decided against requiring more extensive disclosures previously proposed in 2003, such as certain transactions or discussions during the 12 preceding months and any holdings of 5% or more of the shares of competitors. The SEC believed such disclosures would be impractical and potentially deter the exercise of shareholder nomination rights.

*Liability for and Amendment of Schedule 14N.* Although the company would be required to include these disclosures in its proxy materials, the nominating shareholder or group would be liable for any false or misleading statements in such disclosures. The proxy rules would provide that the company does not have any liability for such disclosures unless it knows or has reason to know the information is false.

The Schedule 14N would be required to promptly amended for any material change. In addition, an amendment would be required within 10 days of announcement of final election results to disclose the nominating shareholder’s intention with respect to continued ownership of its shares.

*Changes to Proxy Card.* Under the proposed rules, if a shareholder nominee is included, the company proxy card may not give shareholders the option of voting for or withholding authority for company nominees as a group, but would instead require each nominee be voted on separately.

*Timetable for Submission of 14N and Company Response.* The Schedule 14N would need to be filed by the date specified in the company’s advance notice provision in its charter or bylaws or, where no such provision exists, at least 120 days prior to the date of mailing the prior year’s proxy statement. In cases where no annual meeting was held the prior year, or the date is changed by more than 30 calendar days, then the company would be required to disclose the deadline for shareholder nominations on Form 8-K.

The proposed rules contain a specific deadlines applicable to the company and the nominating shareholder based on the date of receipt of the 14N and the mailing of the company’s proxy materials. The process generally would operate as follows:

Due Date	Action Required
Date set by company’s advance notice provision or, in the absence of such a provision, 120 days before the anniversary of the date that the company mailed the prior year’s proxy materials	Nominating shareholder or group must provide and file notice on Schedule 14N
Within 14 calendar days after the company’s receipt of the nominating shareholder’s or group’s notice on Schedule 14N	Company must notify the nominating shareholder or group of any determination not to include the nominee or nominees
Within 14 calendar days after the nominating shareholder’s or group’s receipt of the company’s deficiency notice	Nominating shareholder must respond to the company’s deficiency notice

No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC	Company must provide notice of its intent to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination to the SEC
Within 14 calendar days of the nominating shareholder's or group's receipt of the company's notice to the SEC	Nominating shareholder or group could submit a response to the company's notice to the SEC staff
As soon as practicable	SEC staff would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group
No later than 30 calendar days before the company files its definitive proxy statement and form of proxy with the SEC	Company must provide the nominating shareholder or group with notice of whether it will include or exclude the shareholder's nominee or nominees

In light of these deadlines, it would be prudent for companies to review their advance notice provisions to determine if they may need to be amended in order to accommodate such deadlines if the proposed rules are finally adopted.

As proposed, inclusion of a shareholder nominee in the company's proxy materials would not by itself require the company to file a preliminary proxy statement.

*Ancillary Exemptions.* The proposal also includes exemptions for certain limited written communications by shareholders seeking to form a shareholder group and for nominating shareholders in support of a nominee for director.

Additionally, the proposal clarifies that a shareholder would not lose eligibility to use Schedule 13G solely as a result of making a nomination, soliciting in favor of a nominee or having a nominee elected under the proposed rules. (The exception would not apply after the election of the nominee).

Further, the proposed rule would provide a safe harbor for a nominating shareholder from being deemed an "affiliate" under securities laws solely as a result of nominating a candidate or soliciting in support, including after election of such candidate, if successful.

## **Expansion of Shareholder Election Proposals**

The SEC is also proposing to narrow the existing Rule 14a-8 election exclusion, which currently permits companies to exclude shareholder proposals that would result in an immediate election contest or establish a process to conduct future election contests by requiring inclusion of shareholder nominees. The amended rule would require inclusion of proposals from qualifying shareholders that would amend,

or that request an amendment to, a company's charter or bylaws concerning its nomination procedures or other director nomination disclosure provisions - so long as those disclosure provisions do not conflict with proposed Rule 14a-11. Consistent with current practice, a company could exclude certain proposals that relate to specific directors or nominees.

The SEC observed that if a company's charter or bylaws prohibit shareholder nomination rights, shareholders who desire to amend the provision may submit a shareholder proposal, which the company would not be permitted to exclude under Rule 14a-8.

The proposals would not alter the existing eligibility requirements under Rule 14a-8, namely stock ownership of \$2,000 in market value (or 1%, if less) for at least one year prior to submitting the proposal.

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