

To: Our Clients and Friends

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SEC Adopts Rules Allowing Shareholder Access to Company Proxy Materials

Yesterday, the Securities and Exchange Commission (the "SEC") voted to adopt new rules that will require companies to include in their proxy materials nominations for election as directors submitted by eligible shareholders, subject to certain conditions. The proposal was adopted by a divided 3-2 vote at an SEC open meeting. Commissioners Casey and Paredes dissented, viewing the rules as intruding on substantive corporate affairs traditionally regulated by state law.

The new rules will apply to all companies subject to SEC proxy rules, including investment companies and controlled companies, except:

- Companies subject to such rules solely due to debt registered under Section 12 of the Securities Exchange Act of 1934; and
- Where state or foreign law or governing documents prohibit shareholders from nominating a candidate for director.

Foreign private issuers are not covered, as they are exempt from SEC proxy rules.

The new rules will be effective 60 days after publication in the Federal Register, with shareholder access permitted no earlier than 150 days and no later than 120 days prior to the anniversary date of the mailing of prior year's proxy materials. The rules will be available if the window remains open after their effective date. Accordingly, if the new rules were to become effective on November 1, 2010, they would apply to companies that mailed their 2010 proxy statements after March 1.

Effectiveness of the new rules will be delayed for three years for smaller reporting companies, to allow the SEC time to monitor implementation and make adjustments, if desired.

The text of the new rules is available [here](#).

Executive Summary

Eligible shareholders can require a company to include one or more nominees in the company's proxy materials, unless applicable laws or governing documents prohibit nominations by shareholders. Companies will only be required to include up to the greater of (i) 25% of the company's directors or (ii) one nominee. The rule sets priorities in case of multiple nominations.

To be eligible, the nominating shareholder or group must, among other requirements, (i) own at least 3% of the total voting power (which may be aggregated among shareholders), (ii) have held such securities for at least three years, and continue to hold them through the shareholder meeting, (iii) not have intent to change control of the company or to gain more board seats than permitted by the rule, and (iv) not have any agreement with the company regarding the nomination.

For purposes of the 3% calculation, only shares over which the holder has both voting and investment power, either directly or through any person acting on their behalf, are counted. In addition, borrowed shares are excluded, short positions must be netted, and shares loaned out will count if they can be recalled and will be recalled if the nominee is included.

To be eligible, (i) the nominee's candidacy must (x) not violate applicable law or (except as to independence) stock exchange rules and (y) satisfy the objective independence standards of the stock exchange and (ii) the nominee may not have any agreement with the company regarding the nomination.

The nominating shareholder or group must file a Schedule 14N generally no earlier than 150 days and no less than 120 days prior to the anniversary date of mailing the prior year's proxy statement. The 14N must set forth detailed disclosures regarding the stock ownership and eligibility of the nominating shareholder and nominee, along with biographical and other information. It may also provide a statement in support of the nominee (up to 500 words per nominee) for inclusion in the proxy statement.

Companies may seek to exclude a nominee under limited circumstances using a no-action letter process similar to that for Rule 14a-8 shareholder proposals.

The nominating shareholder or group will be liable for any false or misleading statements in the 14N or other disclosures. The nominating shareholder will have liability regardless of whether that information is ultimately included in the company's proxy statement. The company will not have liability for information provided by the nominating shareholder and included in its proxy statement even under circumstances in which it knows or has reason to know such information is false.

The SEC adopted new exemptions for certain limited communications by shareholders seeking to form a shareholder group and for nominating shareholders in support of a nominee for director.

The SEC narrowed the existing Rule 14a-8 election exclusion so that companies must include proposals 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 they do not

conflict with new Rule 14a-11 or state, federal or foreign law. A company can exclude certain types of proposals that relate to specific directors or nominees or the upcoming election.

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 new rules are the culmination of a series of proposals that began in October 2003. Since then, the SEC has considered the issue on numerous occasions and conducted a number of forums to solicit input from public companies, investors and commentators, with its most recent proposal made in May 2009.

Three of the five Commissioners believe that facilitating the ability of shareholders to exercise their rights under state law to nominate directors will enhance director accountability. By contrast, the two dissenting Commissioners believe that mandating a federal right of proxy access undermines the traditional state law approach of allowing “private ordering” by shareholders, noting that new rules will not allow a company to adopt bylaws restricting or eliminating proxy access, even if approved by shareholders.

The passage of the Dodd-Frank Act in July gave the SEC authority to prescribe rules to require companies to include in its proxy materials shareholder nominees for election to the board. As a result, the SEC believes the Act removed any doubt as to its authority to adopt a rule such as Rule 14a-11.

New Rule 14a-11

Under new Rule 14a-11, eligible shareholders will 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 or foreign law or the company’s charter or bylaws.¹

The rule is mandatory and may not be restricted by applicable state or foreign laws or a company’s governing documents. As a result, companies may not “opt out,” even with shareholder approval.

The new rule does not require a triggering event in order for shareholder access 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. In addition, the rule will apply regardless of whether the company is subject to a concurrent proxy contest; however, the nominating shareholder may not be a member of that group or separately solicit for the nominees in such a contest.

Maximum Number of Nominees

A company will only be required to include up to the greater of (x) 25% of the company’s directors (rounded down to the nearest whole number) or (y) one nominee. To address specific situations, the rule provides as follows:

¹ The SEC noted that it was not aware of any jurisdiction that prohibits shareholders from nominating directors.

- *Prior Nominees Continuing as Directors.* 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.
- *Classified Board.* In the case of a classified board, the 25% calculation is based on the total number of board seats.
- *Different Voting Rights in Elections.* If a company has multiples classes of stock, the maximum number of candidates a shareholder can nominate would be based on the total board size. If shareholders can elect a subset of the full board or the company has multiple classes of eligible securities, then the maximum may not exceed the number of director seats the class held by the shareholder is entitled to elect.
- *Inclusion of Shareholder Nominees as Company Nominees.* If the nominating shareholder files its notice on Schedule 14N (discussed below) before beginning discussions with the company, nominees that the company agrees to include as a result of such negotiations would count towards the 25% maximum. However, incumbent directors that are re-nominated by the board would not count towards the maximum.
- *Priority of Nominations; Multiple Nominations.* If a company receives more nominations than required to be included, the company would only be required to include the nominees submitted by the shareholder or group with the highest qualifying voting power percentage. This represents a change from the proposal, which would have favored the first submission.

If that shareholder does not nominate the maximum number permitted, the nominee(s) of the nominating shareholder with the next highest percentage would be included, with the rule addressing priorities in specific situations, including if a nominating shareholder or group or nominee withdraws or becomes ineligible.

Once a company has commenced printing its proxy materials, it would not be required to include a substitute nominee(s).

Eligible Shareholders

To be eligible, the nominating shareholder or group must meet the following requirements:

- *Ownership Threshold.* It must own at least 3% of total voting power of shares entitled to vote in director elections (with aggregation of holdings by shareholders permitted).

The ownership requirements are changed from the proposal, which had reflected 1%, 3% or 5% ownership levels based on the size of the company. In computing ownership, the SEC adopted several refinements to the proposal:

- Only shares subject to SEC proxy rules are included, and over which the nominating shareholder has both voting and investment power, either directly or through any person acting on their behalf;

- Shares loaned to a third party may be included in the total only if the nominating shareholder has the right to recall the loaned shares and will recall such shares upon notice that the nominee(s) will be included in the company's proxy statement; and
- Shares sold in a short sale that is not closed out, or that have been borrowed other than a short sale, must be subtracted.
- In the case of multiple classes of stock with unequal voting rights and the classes vote together on the election of directors, then voting power is based on the collective voting power. In the case of multiple classes that do not vote together (where, e.g., each class elects a subset of directors), then voting power is based on the voting power of the class or classes of stock that vote together for the nominee, rather than the voting power of all classes.

Ownership can be demonstrated by (1) record ownership, if applicable, (2) written verification from the "record" holder (within seven days of the notice date), or (3) attaching or incorporating a Schedule 13D or 13G or Form 3, 4 or 5, if applicable.

- *Holding Period.* It must have held the minimum amount of securities above continuously for at least three years (lengthened from the one year period in the proposal); continue to hold such securities through the shareholder meeting; and represent the intent to continue to hold those securities through the shareholder meeting.
- *No Change in Control Intent.* It must not hold the securities for the purpose or effect of changing control of the company or to gain a number of seats on the board that exceeds the maximum permitted under the rule, and must certify to that effect.

Consistent with the proposal, the term "change in control" remains undefined. The first portion of this certification mirrors the corresponding language in Schedule 13G.

It appears that a nominating shareholder would not be restricted from seeking control in the future. As a result, a nominating shareholder would presumably be free to change its mind. In response to concerns regarding potential abuse of the intent requirement, the SEC noted: (1) companies can seek to exclude proposals through the no-action letter process discussed below; (2) nominating shareholders would have liability under the proxy rules for misleading disclosures; (3) companies can seek relief through private litigation; and (4) the SEC can take enforcement action.

- *No Agreement with Company.* It must not have any agreement with the company regarding the nomination.

This provision is intended to prevent a nominating shareholder from acting as a surrogate for the company or its management to block usage by others. However, an instruction clarifies that it would not apply to unsuccessful negotiations regarding whether a company is required to include a nominee.

- *Required Notice.* It must provide the required notice on Schedule 14N within the prescribed window, as discussed below.

The SEC did not adopt two other requirements:

- *No Requirement to Attend Meeting.* There is no requirement that the nominating shareholder or representatives appear at the meeting and present the nominee. The SEC noted that state law will control what happens if the candidate is not nominated because the proponent does not attend or make other arrangements.
- *No Limit on Resubmission.* There is no limit on the ability of a nominating shareholder to utilize the rule due to failure to receive significant shareholder votes in a previous election.

A company need not include a nominee if a nominating shareholder or group:

- Becomes a member of any other group with persons soliciting or nominating in connection with the upcoming election;
- Separately solicits, other than pursuant to the new exemption described below, for the shareholders' nominees or for or against the company's nominees; or
- Is a participant in another person's solicitation in connection with the upcoming election.

Eligible Nominees

Eligible nominees to the board of directors must meet the following criteria (subject to potential cure during the 14-day time period provided in the rule):

- *Consistent with Applicable Laws.* The nominee's candidacy and, if elected, board membership, must not violate federal or state law (or applicable stock exchange requirements, if any, other than those related to independence).²
- *Independence Requirements and other Director Qualifications.* The nominee must satisfy the objective independence standards of the applicable stock exchange on which the company is listed (subject to cure within the required time period).

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, the nominee need not meet a company's own director independence criteria.

The SEC believes that disclosure by the company in its proxy materials can address many of the concerns raised as to director qualifications, such as whether a nominee meets the company's requirements and whether, due to a nominee's failure to meet additional independence requirements, independent directors may have to assume additional duties or companies may need to increase the size of the board or recruit additional directors.

- *No Agreement with the Company.* The nominee may not have any direct or indirect agreement with the company regarding the nomination of the nominee.

² The SEC is not aware of other exchange requirements related to director qualifications, but included this provision in case any would be adopted.

The SEC did not adopt certain other eligibility criteria:

- *No Limit on Relationship between Nominating Shareholder and Nominee.* The rule does not restrict any relationships between the nominee and the nominating shareholder or group. The SEC noted that a nominee would have the same duties to the corporation as other directors, if elected, and that companies could disclose any concerns that a nominee may not represent the views of shareholders in its proxy materials opposing the nomination.
- *No Limit on Resubmission of Nominees.* As discussed above, the rule does not contain any limit on renomination of a candidate who failed to achieve significant shareholder support in a previous election.

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, which must disclose:

- the name and address of the nominating shareholder or each member of the group;
- the amount and percentage of securities held and entitled to vote on the election of directors and the voting power derived from such securities and from securities loaned or sold in an open short sale;
- a written statement from the record holder, or broker-nominee, verifying that, within seven days prior to the notice, the shareholder continuously held the qualifying amount of securities for at least three years;
- a representation of intent to continue to hold the qualifying amount of securities through the date of the shareholder meeting;
- a statement of intent with respect to continued ownership after the election (which may be contingent on the election results);
- a statement that the nominee consents to being named in the proxy materials and, if elected, to serve on the board;
- biographical and other information about the nominating shareholder or group and the nominee(s), similar to the disclosure currently required in a contested election, 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;
- to the best of the nominating shareholder's knowledge, whether the nominee meets the director qualifications set forth in the company's governing documents and a statement that the nominee meets the objective criteria for "independence" of the applicable stock exchange;
- the nature and extent of relationships between the nominating shareholder or group, the nominee and/or the company or an affiliate of the company;
- any website address on which the nominating shareholder may publish soliciting materials;

- if desired to be included in the proxy statement, a statement in support of the nominee(s), which may not exceed 500 words per nominee; and
- a certification regarding the lack of intent to change control or to gain a number of seats on the board that exceeds the maximum permitted under the rule, and that the nominating shareholder and nominee satisfy the applicable requirements of the rule.

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 new Rule 14a-18, subject to somewhat different deadlines.

Timetable for Submission of 14N and Company Response; New 8-K Item 5.08

The Schedule 14N would need to be filed via Edgar and transmitted to the company no earlier than 150 days and no less than 120 days prior to the anniversary date of mailing the prior year’s proxy statement. This replaces the proposed deadline tied to advance notice bylaws due to concerns that some companies with shorter deadlines may not have enough time to respond, with provision for a window period intended to promote dialogue with the board.

In cases where no annual meeting was held the prior year, or the date is changed by more than 30 calendar days, the nominating shareholder must provide notice a reasonable time before mailing, and the company would be required to disclose the deadline on Form 8-K under new Item 5.08.

If the company will include a nominee, the company is required to notify the nominating shareholder or group no later than 30 calendar days before filing its definitive proxy materials. This is intended to provide the nominating shareholder with sufficient time to engage in soliciting activities.

If the company intends to exclude a nominee or supporting statement, the following process must be followed, with notification required to be postmarked or electronically transmitted by the respective deadlines:

Due Date	Action Required
No earlier than 150 calendar days and no later than 120 calendar 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
Not later than 14 calendar days after the close of the window period for submission of nominations	Company must notify the nominating shareholder or group (or its authorized representative) of any determination not to include the nominee or nominees or supporting statement

Not later than 14 calendar days after the nominating shareholder's or group's receipt of the company's deficiency notice	Nominating shareholder or group must respond to the company's deficiency notice and, where applicable, cure any eligibility or procedural defects
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC (upon showing good cause, the SEC staff may excuse a late notice from the company)	Company must provide notice of its intent to exclude the nominee(s) or supporting statement and the basis for its determination to the SEC and, if desired, seek a no-action letter from the SEC staff as to its determination
Not later than 14 calendar days after the nominating shareholder's or group's receipt of the company's notice to the SEC	Nominating shareholder or group may submit a response to the company's notice to the SEC staff
As soon as practicable	If requested by the company, SEC staff would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group
Promptly following receipt of the SEC staff's informal statement of its views	Company must provide notice to the nominating shareholder or group stating whether it will include or exclude the nominee

Under the new rule, a company may seek to exclude a nominee using the "no-action" procedure described above because:

- the rule is not applicable to the company;
- the nominating shareholder or group or nominee fail to satisfy the eligibility requirements; or
- including the nominee or nominees would result in the company exceeding the maximum number of nominees it is required to include in its proxy materials.

Submission of a supporting statement exceeding 500 words per nominee would not permit exclusion of the nominee, but the company may exclude such statement, subject to the procedures described above.

Neither the composition of the group nor the nominee may be changed as a means to correct any deficiency. However, if a nominating shareholder submits too many nominees, it may specify which one will be excluded.

Unlike the proposal, the new rule will not allow exclusion of a nominee if any required representation or certification is materially false or misleading. Instead, the SEC expects companies to address such concerns through their own disclosures and, if necessary, through private litigation, as in traditional proxy contests.

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

Changes to Proxy Card

As proposed, 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. However, companies may identify shareholder nominees as such and recommend whether shareholders vote for, against or withhold vote on those nominees and management nominees.

Liability for and Amendment of Schedule 14N

Although the company would be required to include Schedule 14N disclosures in its proxy materials, the nominating shareholder or group would be liable for any false or misleading statements in the 14N or other disclosures. As changed from the proposal, (1) the nominating shareholder will have liability regardless of whether that information is ultimately included in the company's proxy statement and (2) the company will not have liability for information provided by the nominating shareholder or group and included in its proxy statement, even under circumstances in which it knows or has reason to know such information is false.

Schedule 14A will provide that such information required to be included will not be deemed incorporated by reference into any other filings, except to the extent specifically incorporated by the company.

The Schedule 14N would be required to be promptly amended for any material change, including withdrawal of a nominating shareholder or nominee, and the reasons for any such withdrawal. In addition, as in the proposal, 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.

Additional Reporting Requirements

As noted above, in cases where no annual meeting was held the prior year, or the date is changed by more than 30 calendar days, the nominating shareholder must provide notice a reasonable time before mailing, and the company would be required to disclose the deadline on Form 8-K under new Item 5.08. The 8-K would be due within four business days of determining the anticipated date of the meeting. In addition, if a company were required to include shareholder nominees in proxy materials pursuant to applicable state or federal law, or its governing documents, then it would be required to disclose the date the Schedule 14N would be due pursuant to Rule 14a-18.

Rule 14a-5 is being amended to require companies to also disclose in proxy statements the deadline for submitting nominees for inclusion in proxy materials for the next annual meeting.

Ancillary Exemptions

Solicitation Exemptions. The SEC also adopted new exemptions for certain limited communications by shareholders seeking to form a shareholder group and for nominating shareholders in support of a nominee for director. The first applies to written and oral solicitations by shareholders who are seeking to form a nominating shareholder group and require:

- that the shareholder not have any purpose or effect of changing control of the company, or to gain more seats on the board permitted under Rule 14a-11;
- limiting the content of written communications to certain specified information;
- filing all written soliciting materials sent to shareholders under the exemption with the SEC or, in the case of oral communications, a filing on Schedule 14N with the appropriate box checked before or at the same time as the first solicitation; and
- no solicitations in connection with the election of directors other than pursuant to the provisions of Rule 14a-11 and the new exemption described below.

The second new exemption applies to written and oral solicitations by a nominating shareholder or group after receiving notice that its nominees will be included in the company's proxy materials pursuant to Rule 14a-11 in favor of shareholder nominees or for or against company nominees. The exemption requires:

- that the nominating shareholder or group does not seek the power to act as a proxy for another shareholder;
- disclosing certain information (including the identity of the nominating shareholder or group, and a prominent legend about availability of the proxy materials) in all written communications;
- filing all written soliciting materials in reliance on the exemption with the SEC under cover of Schedule 14N with the appropriate box checked, no later than the date first published or sent to shareholders; and
- no solicitations in connection with the subject election of directors other than pursuant to the provisions of Rule 14a-11 and this new exemption.

Neither exemption will apply to solicitations for nominees included pursuant to a company's governing documents or applicable state laws, as opposed to Rule 14a-11.

Schedule 13G. As proposed, a shareholder will 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 new rule. The exception would not apply after the election of the nominee. Further, it would not apply to activities other than those specifically exempted, or to nominations pursuant to an applicable state or foreign law or the company's governing documents.

Status as Affiliate. In contrast to the proposal, the SEC did not adopt a safe harbor for a nominating shareholder from being deemed an “affiliate” under securities laws due to nominating a candidate or soliciting in support.

Expansion of Shareholder Election Proposals

As proposed, the SEC narrowed the existing Rule 14a-8 election exclusion, which permitted 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 will 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 they do not conflict with new Rule 14a-11 or state, federal or foreign law. Consistent with current practice, a company could exclude certain types of proposals that relate to specific directors or nominees or the upcoming election.

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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