

To: Our Clients and Friends

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SEC Announces Proposed Rules Allowing Shareholder Access to Company Proxy Materials

On May 20, 2009, the Securities and Exchange Commission (the "SEC") announced 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.

The SEC approved the proposals by a vote of 3-2, with Commissioners Casey and Paredes dissenting principally on the basis that they viewed the proposed rules as intruding on substantive corporate affairs traditionally regulated by state law.

The proposed rules would apply to all SEC-reporting companies, including investment companies, except companies which have only publicly-issued debt - 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 text of the proposed rules has not yet been publicly released. Accordingly, the description below is based on the statements made at the SEC's open meeting and subject to change upon review of the proposals. We expect to supplement this memorandum with further details after the SEC publishes the complete text of the proposal.

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 of proposals 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.

A majority of the Commissioners believe 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

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shareholders to exercise their rights under state law to nominate directors will enhance director accountability.

In light of the controversy surrounding the proposals (as illustrated by the objections of two Commissioners described below), the SEC encourages any interested parties to comment on the proposals. Comments must be received by the SEC within 60 days after the proposed rules are published in the Federal Register.

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 the shareholders are otherwise prohibited from nominating a candidate for election as a director under applicable state law or the company's charter or bylaws. An eligible shareholder or group would be permitted to include up to the greater of (x) 25% of the company's directors or (y) one nominee. The SEC staff did not discuss whether shareholders would be permitted to include such nominees in successive elections (and thereby nominate more than 25% of the board over time). If a company receives more nominations than required to be included, the company would only be required to include the first validly submitted nominees.

Eligible Shareholders. To be eligible, the 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.

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.

The SEC staff did not address at the SEC meeting the impact of any additional independence requirements that a company may have adopted.

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 number and percentage of shares owned by the nominating shareholder;
- the length of ownership;
- a representation of intent to continue to hold the shares through the date of the shareholder meeting;
- a certification regarding the lack of intent to change control or to gain more than minority representation on the board of directors; and
- information regarding the nominating shareholder and the nominees similar to that currently required in a proxy contest.

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 rule 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.

Based on discussion at the SEC meeting, the Schedule 14N would need to be filed at least 120 days prior the date of mailing the prior year's proxy statement (or the deadline provided in the company's advance notice bylaw). The proposing release, when published, will set forth a timeline detailing the specific deadlines for the company to respond or object to a Schedule 14N.

The Commissioners noted that the SEC would likely need to allocate significant personnel to review Schedule 14Ns and to respond to objections or notices filed by companies and nominating shareholders.

Ancillary Exemptions. The proposal also includes exemptions for solicitations made 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.

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 “relate to an election.” 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 Rule 14a-11 above.

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.

Opposition to Proposals

Commissioners Casey and Paredes strongly opposed the proposals which they viewed as an improper federal intrusion into state authority over internal corporate affairs. In particular, the concerns identified by Commissioner Casey included the following:

- the current financial crisis would not justify application of the rules to all public companies, including those with no connection to the crisis;
- the proposal intrudes on traditional state law authority, and impedes the evolution of corporate governance through state experimentation, noting that both Delaware and North Dakota have recently adopted proxy access statutes, and the committee responsible for the Model Business Code is currently considering a proxy access amendment
- the SEC proposed rule would override even those proxy access provisions that have been approved by shareholders, such as provisions that would impose higher ownership thresholds or longer holding periods;
- the authority of the SEC to adopt the proposals is subject to doubt, insofar as it relates to substantive corporate law rather than procedural or disclosure-related matters;
- the existence of significant ongoing debate and lack of consensus points to the need for restraint, and at most adopting a narrowly tailored proposal that merely facilitates state law developments.

As an alternative, Commissioner Paredes would prefer that the SEC amend Rule 14a-8 to permit a proxy access bylaw to be approved by shareholders, so long as permitted by state law.

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