

Securities Alert

Proxy Access: Frequently Asked Questions

September 3, 2010

On August 25, 2010, the Securities and Exchange Commission (SEC) adopted new rules that will allow shareholders to have their director nominees included in company proxy materials.¹ The new rules, which passed by a 3-2 vote of the commissioners at the SEC's August 25, 2010, open meeting, will allow a shareholder (or group of shareholders) who holds at least 3 percent of the total voting power of a company's securities entitled to vote on the election of directors and who has held the shares continuously for at least three years to use management's proxy materials for the nomination of up to 25 percent of the company's board of directors, provided the shareholder is not seeking a change of control of the company or seeking to gain more seats on the board than the maximum number provided for under the new rules. The new rules, which will become effective 60 days after publication in the *Federal Register*, are expected to dramatically change the landscape for the election of directors of public companies.

In this alert, we answer some key questions about the new rules.

COMPANIES AND MEETINGS SUBJECT TO THE NEW RULES

Which companies are subject to the new Rule 14a-11?

The new proxy access rule, Rule 14a-11, applies to all companies that are subject to the proxy rules of the Securities Exchange Act of 1934 ("Exchange Act") (including investment companies registered under Section 8 of the Investment Company Act of 1940),² other than companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12.³ Any company whose applicable state or foreign law or governing documents prohibit shareholders from nominating candidates for the board of directors will be exempt from Rule 14a-11, although the SEC stated in the adopting release that it is not aware of any state whose law prohibits shareholder nominations.

Are smaller reporting companies⁴ subject to Rule 14a-11?

Yes. But recognizing that such companies may have had less experience with shareholder involvement in the proxy process, the SEC has delayed the effectiveness of Rule 14a-11 for smaller reporting companies for three years to allow these companies to observe how the rule operates and prepare for its implementation and to allow the SEC to make adjustments to the rule prior to its applicability to smaller reporting companies.

¹ SEC Release Nos. 33-9136; 34-62764, "Facilitating Shareholder Director Nominations" (August 25, 2010) ("adopting release"), which is available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

² A discussion of the new proxy access rules as they apply to registered investment companies is beyond the scope of this alert.

³ The SEC clarifies in the adopting release that Rule 14a-11 applies to controlled companies and companies that voluntarily register equity securities under Section 12(g) of the Exchange Act. Rule 14a-11 does not apply to foreign private issuers, as they are exempt from the proxy rules.

⁴ The definition of "smaller reporting company" is set forth in Exchange Act Rule 12b-2 and includes, subject to certain exceptions, companies that have a public float of less than \$75 million as of the last business day of their most recently completed second fiscal quarter.



Which shareholder meetings are subject to Rule 14a-11?

Rule 14a-11 requires companies to include shareholder nominees in the company's proxy materials for any annual meeting of shareholders, or special meeting in lieu of the annual meeting, at which directors will be elected. Therefore, special meetings that are not in lieu of an annual meeting—such as those that are called, for example, to fill vacancies on a board of directors—are not subject to Rule 14a-11.

EFFECTIVE DATE OF THE NEW RULES

When do the new rules become effective?

The new rules become effective 60 days after publication in the *Federal Register*. Under Rule 14a-11, however, shareholders must submit nominees no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary date that the company mailed its proxy materials for the prior year's annual meeting. Therefore, a company will be subject to Rule 14a-11 during the 2011 proxy season if this 120-day deadline falls on or after the effective date of the new rules. As mentioned above, the effectiveness of Rule 14a-11 has been deferred for three years for smaller reporting companies.

SHAREHOLDER ELIGIBILITY REQUIREMENTS

Which shareholders are eligible to have their nominees included in the company's proxy materials?

Under Rule 14a-11, shareholders who hold, either individually or in the aggregate, at least 3 percent of the total voting power of the company's securities entitled to vote on the election of directors may include their director nominees in company proxy materials, provided that the shareholder has held the shares that are used for purposes of meeting the ownership threshold continuously for at least three years as of the date the shareholder gives the company notice of its nominees and continues to hold the requisite shares through the date of the shareholder meeting.

Can shareholders form groups to satisfy the share ownership requirement?

Yes. Shareholders will be able to aggregate their holdings in order to meet the threshold requirements, and, in such case, each member of the shareholder group must satisfy the three-year holding requirement.

How would a shareholder determine whether it has the requisite voting power to meet the ownership threshold?

To satisfy the ownership requirement, a nominating shareholder or group must hold a class of securities subject to the proxy solicitation rules. Further, a nominating shareholder or group must hold, either directly or through any person acting on its behalf, **both** investment and voting power over the shares used to meet the minimum ownership threshold. As such, securities that could be acquired, including securities underlying options that are exercisable but have not been exercised, cannot be counted in the calculation. Securities loaned to a third party can be counted toward the ownership requirement provided the nominating shareholder or group has the right to recall the loaned securities and will do so upon being notified that any of its nominees will be included in the company's proxy materials. Borrowed shares and securities sold in a short sale⁵ are excluded from the ownership calculation. The new rule provides details on how to calculate the ownership threshold, as discussed below.

Rule 14a-11 does not use the definition of "beneficial ownership" set forth in Rule 13d-3 of the Exchange Act, which is used to calculate ownership for Schedules 13D and 13G and for the beneficial ownership tables in proxy statements and registration statements. Rather, the percentage of a company's voting power held by a shareholder for purposes of Rule 14a-11 is calculated by dividing the numerator and the denominator as follows—

- The numerator includes the total voting power of the company's securities held by the nominating shareholder. For purposes of calculating the numerator, only securities with respect to which solicitation of a proxy would require compliance with the proxy rules are included. Privately held classes of securities are, thereby, excluded from the numerator. The numerator is calculated by—

⁵ Rule 200(a) of Regulation SHO defines a "short sale" as any sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller.

- determining the number of votes derived from securities over which the nominating shareholder has voting power **and** investment power,⁶ either directly or through any person acting on its behalf
 - adding the votes attributable to loaned securities that the shareholder has the right to recall and will recall upon being notified that any of its nominees will be included on the company’s proxy materials
 - subtracting securities sold in a short sale or borrowed for purposes other than a short sale.
- The denominator includes the total voting power of the company’s securities. This number includes the aggregate number of votes derived from all classes of securities that are entitled to vote on the election of directors (regardless of whether solicitation of a proxy with respect to those securities would require compliance with the proxy rules).

If a company has multiple classes of securities that do not vote together in the election of directors, the voting power calculation of both the numerator and denominator set forth above should be determined only on the basis of the voting power of the class of securities that would be voting together on the election of the person(s) sought to be nominated by the nominating shareholder or group.

In determining the total voting power of the company’s securities, a nominating shareholder or group will be entitled to rely on information set forth in the company’s most recent quarterly or annual report, or any subsequent current report, filed with the SEC unless the nominating shareholder or group knows or has reason to know that such information is inaccurate.

Are there any other eligibility requirements for nominating shareholders?

In addition to the requirements discussed above, neither the nominating shareholder nor any member of the nominating shareholder group may—

- hold the shares with the purpose, or with the effect, of changing control of the company or to gain more seats on the board than the maximum number provided for under Rule 14a-11⁷
- have an agreement with the company regarding the nomination⁸
- be a member of any other group with persons engaged in soliciting or other nominating activities in connection with the election of directors, separately conduct a solicitation in connection with the election of directors other than an exempt solicitation relating to its nominees or for or against the company’s nominees or participate in another person’s solicitation in connection with the election of directors.

Also, nominating shareholders or members of a nominating shareholder group must provide the company with proof of ownership of the amount of securities used for satisfying the eligibility requirements, as discussed in more detail below.

NUMBER OF NOMINEES

How many shareholder nominees can be included in the company’s proxy statement?

A company will be required to include no more than one shareholder nominee or the number of nominees that represents 25 percent of the company’s board of directors, whichever is greater. Where a company has a director (or directors) currently serving on its board of directors who was elected as a shareholder nominee pursuant to new Rule 14a-11, and the term of that director extends past the date of the shareholder meeting for which the company is soliciting proxies for the election of directors, the company will not be required to include in its proxy materials more shareholder nominees than could result in the total number of directors serving on the board that were elected as shareholder nominees being greater than one shareholder nominee or 25 percent of the company’s board of directors, whichever is greater. If a company decides to nominate a director who was nominated by a shareholder during a prior year’s election, however, that director will be

⁶ Unlike in “beneficial ownership” calculations, a shareholder is not able to include shares that it has the ability to acquire but has not yet acquired, such as through the exercise of an option or the conversion of convertible notes.

⁷ The shareholder must provide a certification to this effect.

⁸ Unsuccessful negotiations that do not result in an agreement regarding whether a company is required to include a nominee in its proxy statement will not represent a direct or indirect agreement with the company.

considered a company nominee and, therefore, will not count toward the maximum. For companies with classified boards, the 25 percent limit will be calculated on the total number of board seats, not the lesser number being voted on.

What happens if multiple shareholders or shareholder groups nominate directors?

If the company receives more shareholder director nominees than it is required to include, the nominees to be included will be those put forward by the nominating shareholder or group with the highest qualifying voting power percentage disclosed as of the date of filing the notice required by the new proxy access rules, Schedule 14N. If the nominating shareholder or group with the highest qualifying voting power percentage does not nominate the maximum number of directors allowed under the rule, then the nominee or nominees of the nominating shareholder or group with the next-highest qualifying voting power percentage from whom the company receives timely notice will be included, up to the maximum number of shareholder nominees required to be included by the company.

What if the company has multiple classes of securities, and each class is entitled to elect a specified number of directors?

When a company has multiple classes of securities, and each class is entitled to elect a specified number of directors, the maximum number of nominees a company will be required to include under Rule 14a-11 may not exceed the number of director seats the class of shares held by the nominating shareholder is entitled to elect. In such case, the company must include the lesser of the number of nominees that the nominating shareholder's or group's class is entitled to elect or 25 percent of the board, but in no case fewer than one nominee. For example, if a company has both common and preferred stock that are listed on an exchange, and the preferred stock is entitled to elect two of the company's 12 directors, a nominating shareholder who holds preferred stock would only be eligible to nominate two of the 12 directors (the lesser of the number of nominees the shareholder is entitled to elect, which is two, or 25 percent of 12, which is three).

What if a company agrees to nominate a candidate who is proposed by a shareholder under Rule 14a-11?

When a company negotiates with a nominating shareholder or group, and the company agrees to include the nominating shareholder's or group's nominees on the company's proxy card as company nominees, such nominees will count toward the 25 percent maximum so long as the nominating shareholder or group filed its Schedule 14N before beginning any discussions with the company about the nomination and would otherwise be eligible to have its nominees included in the company's proxy materials.

What if a nominating shareholder or group or a nominee withdraws or is disqualified?

If a nominating shareholder or group withdraws or is disqualified, the company must include in its proxy materials the nominee(s) of the nominating shareholder or group with the next-highest qualifying voting power percentage from whom the company received timely notice.

If a nominee withdraws or is disqualified after the company provides notice to the nominating shareholder or group of its intent to include the nominee(s) in its proxy materials, the company must include in its proxy materials any other eligible nominee submitted by that nominating shareholder or group. If additional nominees were not submitted, the company must then include the nominee(s) of the nominating shareholder or group with the next-highest voting power percentage from whom the company received timely notice.

Notwithstanding the foregoing, once a company has commenced printing its proxy materials, it is not required to include a substitute nominee or nominees in place of withdrawn or disqualified nominees.

What would happen if 25 percent of the company's board is not a whole number?

The maximum number of shareholder nominees that the company will be required to include in its proxy materials should be rounded down to the closest whole number below 25 percent. For example, if the company's board consists of 12, 13, 14 or 15 directors, the company is only required to include three shareholder nominees in its proxy statement.

SHAREHOLDER NOMINEE REQUIREMENTS

Does a nominating shareholder's nominee have to satisfy any requirements?

Yes. Nominees must satisfy the following requirements—

- **Independence.** The nominee must meet the objective independence standards of the national securities exchange or national securities association to which the company is subject. Those portions of the independence requirements that involve subjective determinations or that apply only to audit committees and not to directors generally do not have to be satisfied.
- **No violation of law.** A company is not required to include in its proxy materials any shareholder nominee whose candidacy or, if elected, board membership would violate controlling federal, state or foreign law or any rules of the national securities exchange or national securities association (other than independence requirements as discussed above) to which the company is subject unless such violation can be cured during the time period permitted under the rule.⁹
- **No agreement with company regarding nomination.** Finally, neither the nominee nor the nominating shareholder (or any member of the nominating group) is allowed to have an agreement with the company regarding the nomination. This requirement is designed to reduce the risk of a nominating shareholder acting as a surrogate for the company or its management in order to block usage of the rule by another nominating shareholder or group. Instructions to the new rule clarify that negotiations with a company's nominating committee or board to have a nominee included in management's slate, where those negotiations are unsuccessful, or negotiations are limited to whether the company is required to include a shareholder nominee in the company's proxy materials under Rule 14a-11, would not be deemed an agreement for purposes of the rule.

Rule 14a-11 does not contain any restrictions on the relationships between a nominating shareholder or group and its nominees. Consequently, nominees do not have to be independent of the nominating shareholder or group and, in fact, can be members or affiliates of the nominating shareholder or group.

Will shareholders who nominate directors under Rule 14a-11 be deemed to be affiliates of the company?

It depends. Shareholders who nominate directors under Rule 14a-11 will need to analyze their affiliate status on a case-by-case basis, taking into consideration all relevant factors and circumstances, including the circumstances surrounding the nomination and election of the nominee.

SOLICITING ACTIVITIES BY NOMINATING SHAREHOLDERS

Will communications among shareholders in connection with the formation of a nominating shareholder group be subject to the federal proxy rules?

To facilitate the formation of shareholder groups seeking to avail themselves of the new proxy access rule, the SEC has exempted communications in connection with the formation of these groups from most of the federal proxy rules as set forth below.

- **Written Solicitations.** Any written solicitation by or on behalf of a shareholder¹⁰ in connection with the formation of a nominating shareholder group under Rule 14a-11 will be exempt from most of the proxy rules, including those rules that require the filing of a proxy statement with the SEC,¹¹ provided that (1) any written communication¹²

⁹ The SEC does not allow the exclusion of nominees solely because they do not meet director qualification standards set forth in a company's governing documents, but it requires that nominating shareholders or groups disclose in Schedule 14N whether they believe that the nominees meet such requirements.

¹⁰ For the exemption to apply, the shareholder cannot be holding the securities with the purpose, or with the effect, of changing control of the company or gaining a number of seats on the board that exceeds the maximum number provided for under Rule 14a-11.

¹¹ Such solicitations would be exempt from Rules 14a-3 to 14a-6 (other than 14a-6(g) and 14a-6(p)), 14a-8, 14a-10 and 14a-12 to 14a-15.

includes no more than a statement of each soliciting shareholder's intent to form a nominating shareholder group; identification of, and a brief statement regarding, the potential nominee or nominees or, if nominees have not been identified, the characteristics of the nominee or nominees that the shareholder intends to nominate; the percentage of voting power held by the shareholder or shareholder group; and the means by which shareholders may contact the soliciting shareholder and (2) any written soliciting material is filed under cover of Schedule 14N with the SEC and sent to each national securities exchange on which any class of securities of the company is listed and registered no later than the date the material is first published, sent or given to shareholders.

- **Oral Solicitations.** The SEC has also exempted oral solicitations made in connection with the formation of a nominating shareholder group, but did not include the same limits on oral communications that it did for written communications. In the case of an oral solicitation, the nominating shareholder must file a notice of commencement of the oral solicitation under cover of Schedule 14N, no later than the date of the first such communication.

Although these communications would be exempt from most of the proxy rules, they would remain subject to the anti-fraud provisions of Rule 14a-9.

What about soliciting activities in support of shareholder nominees or against the company's nominees?

Solicitations by or on behalf of a nominating shareholder or group in support of its nominee that is, or will be, included in the company's proxy materials pursuant to Rule 14a-11 or for or against the company's nominee or nominees will be exempt from most of the proxy rules provided that (1) the soliciting party does not at any time during the solicitation seek directly or indirectly, either on its own behalf or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request or act on behalf of a person who furnishes or requests a form of revocation, abstention, consent or authorization; (2) any written communication identifies each nominating shareholder and a description of his or her direct or indirect interests, by security holdings or otherwise, and includes a legend advising shareholders about the company's proxy statement; and (3) any written soliciting material is filed under cover of Schedule 14N with the SEC and sent to each national securities exchange on which any class of securities of the company is traded no later than the date the material is first published, sent or given to shareholders. Nominating shareholders or groups may only rely on this exemption after receiving the company's notice that it will include the shareholder's or group's nominee in the company's proxy materials.

NOTICE AND DISCLOSURE REQUIREMENTS

How will shareholders nominate candidates under Rule 14a-11?

A nominating shareholder or group will be required to provide a notice on Schedule 14N to the company and file the Schedule 14N with the SEC.

When must the notice be provided?

The notice must be provided to the company and filed with the SEC no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting. If the 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 prior year, however, then the nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials. In these situations, the company will be required to disclose the date by which the shareholder must submit the required notice on a new Item 5.08 of Form 8-K within four business days after the company determines the anticipated meeting date.

What information is required in the notice on Schedule 14N?

The notice on Schedule 14N requires the following information—

- the name and address of the nominating shareholder or each member of the nominating shareholder group

¹² "Written communication" includes electronic communications, such as e-mails and Web site postings, and scripts used in connection with oral solicitations. See footnote 647 of the adopting release.

- the amount and percentage of securities held by the nominating shareholder or group members and entitled to vote on the election of directors at the meeting and the voting power derived from securities that have been loaned or sold in a short sale that remains open
- a statement from the “record” holder of the shares held by the nominating shareholder or each member of the nominating shareholder group, or the brokers or banks through which such shares are held,¹³ verifying that, within seven calendar days prior to submitting the notice on Schedule 14N to the company, the shareholder continuously held the qualifying amount of securities for at least three years (this requirement would apply only where the nominating shareholder is not the registered holder of the shares or is not proving ownership by providing previously filed Schedules 13D or 13G or Forms 3, 4 or 5)
- a statement of the nominating shareholder’s or group’s intent to continue to hold the qualifying amount of securities through the shareholder meeting and a statement regarding its intent with respect to continued ownership after the election
- a certification that, to the best of their knowledge and belief, the shares are not held for the purpose, or with the effect, of changing control of the company or gaining more than the maximum number of board seats required under Rule 14a-11
- a certification that, to the best of their knowledge, the nominating shareholder or each member of the nominating shareholder group satisfies the requirements of Rule 14a-11(b), as applicable.

The following information must be included not only in the Schedule 14N, but also in the company’s proxy statement—

- a statement from the nominee that the nominee consents to be named in the company’s proxy materials and to serve on the company’s board, if elected
- disclosure about the nominee complying with the requirements of Items 4(b) (information about persons making solicitation); 5(b) (interests of persons making solicitation); 7(a) (disclosure of certain legal proceedings); 7(b) (disclosure relating to director nominee biographical information, transactions with related persons, Section 16 compliance, audit committee eligibility and financial expert status); and 7(c) (director independence) of Schedule 14A
- disclosure about the nominating shareholder or each member of a nominating shareholder group consistent with the disclosure currently required pursuant to Items 4(b) and 5(b) of Schedule 14A in a contested election
- disclosure about whether the nominating shareholder or any member of a nominating shareholder group has been involved in certain legal proceedings during the past 10 years
- disclosure about whether, to the best of the nominating shareholder’s or group’s knowledge, the nominee meets the director qualifications, if any, set forth in the company’s governing documents
- a statement that, to the best of the nominating shareholder’s or group’s knowledge, the nominee meets the objective criteria for “independence” of the rules of any national securities exchange or national securities association applicable to the company
- the following information regarding the nature and extent of the relationships between the nominating shareholder or nominating shareholder group, the nominee and/or the company or any affiliate of the company—
 - any direct or indirect material interest in any contract or agreement between the nominating shareholder or any member of the nominating shareholder group, the nominee and/or the company or any affiliate of the company (including any employment agreement, collective bargaining agreement or consulting agreement)

¹³ A form of statement from the broker or bank is included in the instructions to Schedule 14N.

- any material pending or threatened litigation in which the nominating shareholder or any member of the nominating shareholder group and/or the nominee is a party or a material participant that involves the company, any of its executive officers or directors or any affiliate of the company
- any other material relationship between the nominating shareholder or any member of the nominating shareholder group, the nominee and/or the company or any affiliate of the company not otherwise disclosed.
- any Web site address on which the nominating shareholder or group may publish soliciting materials
- if desired to be included in the company’s proxy statement, any statement in support of the shareholder nominee(s), which may not exceed 500 words per nominee.

When will a nominating shareholder or group be required to amend a Schedule 14N?

Schedule 14N must be amended promptly if any material change occurs with respect to the nomination or in the disclosure or certifications set forth in the schedule. Also, an amended Schedule 14N must be filed within 10 calendar days of the announcement of the final results of the election, stating the nominating shareholder’s or group’s intention with regard to continued ownership of its shares.

What information on shareholder nominees is the company required to include in its proxy statement?

The company will be required to include in its proxy materials disclosure concerning the nominating shareholder and the shareholder nominee(s) that is similar to the disclosure currently required in a contested election. For a list of the required information, see the second part of the answer above to the question “What information is required in the notice on Schedule 14N?”

What is the company required to include in the form of proxy?

The company is required to identify the shareholder nominees in the company’s form of proxy and may identify the shareholder nominees as such. The company is permitted to recommend whether shareholders should vote for or against, or withhold votes, on those nominees and may continue to recommend that shareholders vote for management nominees. If a shareholder nominee is included in the proxy, the company cannot use the current practice of providing shareholders the option of voting for, or withholding authority to vote for, management nominees as a group because it would result in an advantage to management nominees. Instead, each nominee must be voted on separately.

Is the company responsible for the information included in its proxy statement that is furnished by a nominating shareholder?

No. The company will not be responsible for information that is provided by the nominating shareholder or group under Rule 14a-11 and then repeated by the company in its proxy statement.

Must the company file its proxy statement in preliminary form if a shareholder nominee is included?

No. The rules provide that inclusion of a shareholder nominee in the company’s proxy statement will not require a filing in preliminary form, provided the company is otherwise eligible to file the proxy statement in definitive form. The SEC also clarified that inclusion of a shareholder nominee will not be deemed to be a “solicitation in opposition” for purposes of filing a preliminary proxy statement under the proxy rules.

Under what circumstances may a company exclude a shareholder nominee?

A company can determine that it is not required under Rule 14a-11 to include a nominee from a nominating shareholder or group in its proxy materials if the company determines any of the following—

- Rule 14a-11 is not applicable to the company.
- The nominating shareholder or group or nominee failed to satisfy the eligibility requirements in Rule 14a-11(b). (or)

- The company has received more nominees than it is required to include under Rule 14a-11.

What procedures must the company follow to exclude a nominee from the company's proxy materials?

To exclude a nominee, a company will be required to follow procedures that are similar to the procedures companies currently must follow when seeking to exclude shareholder proposals under Rule 14a-8. Specifically, the company must send a notice to the SEC when it determines not to include a shareholder nominee in its proxy materials, and the company may seek staff advice through a no-action request regarding that determination. The following table sets forth the timeline for the procedures that must be followed.

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 its proxy materials for the prior year's annual meeting	Nominating shareholder or group must provide notice on Schedule 14N to the company and file the Schedule 14N with the SEC
No 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 and explain the basis for its determination
No 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 may correct any eligibility or procedural deficiencies ¹⁴
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC ¹⁵	Company must provide to the SEC notice of its intent to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination and, if desired, seek a no-action letter from the staff with regard to its determination
No 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
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 ¹⁶
Promptly following receipt of the 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

CHANGES TO RULE 14a-8 – THE SHAREHOLDER PROPOSAL RULE

How is Rule 14a-8 being amended?

Rule 14a-8 currently allows companies to omit shareholder proposals that relate to the nomination or election of directors from their proxy materials. The SEC is amending this rule to require companies to include any shareholder proposals that would amend, or request an amendment to, a company's governing documents concerning director nomination procedures or other director nomination disclosure provisions, which proposals do not conflict with new Rule 14a-11, other SEC proxy rules or applicable law. Only shareholders who meet the current eligibility requirements of Rule 14a-8 (which require that

¹⁴ Neither the composition of the nominating shareholder group nor the shareholder nominee may be changed to correct a deficiency, but if the nominating shareholder or group inadvertently submitted a number of nominees exceeding the maximum number the company is required to include, the nominating shareholder or group could specify which nominees are not to be included.

¹⁵ SEC staff may permit the company to make its submission later than 80 calendar days if it demonstrates good cause for missing the deadline.

¹⁶ Note, however, that the SEC staff's determination would not preclude an interested person from pursuing a judicial determination regarding the application of Rule 14a-11.

the shareholder own at least \$2,000 in market value or 1 percent, whichever is less, of the company's shares for at least one year) may submit such proposals.

The SEC is also amending Rule 14a-8 to codify certain prior staff interpretations.

Why is the SEC amending Rule 14a-8?

The SEC wants to allow shareholders the flexibility to propose amendments that would establish procedures for nominating directors, as well as disclosures related to such nominations, that would serve as methods, in addition to Rule 14a-11, for accessing the company's proxy. Any such shareholder proposals will be permitted so long as they do not preclude nominations by shareholders who qualified under Rule 14a-11 to have their nominees included in the company's proxy materials, or violate applicable state law.

Consequently, a state corporate law could provide, or a company could choose to amend its governing documents to provide, for nomination or disclosure rights in addition to those provided pursuant to Rule 14a-11. For example, a company could choose to provide a right for shareholders to have their nominees disclosed in the company's proxy materials regardless of share ownership. In that instance, the company's provision would apply for certain shareholders who would not otherwise have their nominees included in the company's proxy materials pursuant to Rule 14a-11. Note that such provision would be an additional avenue for shareholders to submit nominees for inclusion in company proxy materials, not a substitute or restriction on Rule 14a-11.

What prior staff interpretations are being codified in amended Rule 14a-8?

Although, as discussed above, the SEC is narrowing companies' ability to exclude proposals that relate to the nomination or election of directors from Rule 14a-8, it believes that, under certain circumstances, companies should continue to have the right to exclude proposals related to particular elections and nominations for directors from company proxy materials where such proposals could result in an election contest between company and shareholder nominees without the important protections provided by the disclosure and liability provisions already established in the proxy rules. Therefore, the SEC is also amending Rule 14a-8(i)(8) to make clear that a company may exclude a proposal if the proposal—

- would disqualify a nominee who is standing for election
- would remove a director from office before his or her term expired
- questions the competence, business judgment or character of one or more nominees or directors
- seeks to include a specific individual in the company's proxy materials for election to the board of directors, or
- otherwise could affect the outcome of the upcoming election of directors.

NOMINATIONS PURSUANT TO STATE OR FOREIGN LAW OR COMPANY GOVERNING DOCUMENTS

What procedures must a nominating shareholder follow in order to have its nominees included in the company's proxy statement pursuant to state or foreign law or the company's governing documents?

As contemplated by Rule 14a-8, state or foreign law or the company's governing documents may provide for nomination or disclosure rights in addition to those provided pursuant to Rule 14a-11. A nominating shareholder or group making a nomination pursuant to state or foreign law or a company's governing documents will be required to provide notice to the company of its intent to do so on a Schedule 14N and file the notice with the SEC.

When must the notice on Schedule 14N be provided?

Unlike notices in reliance on Rule 14a-11, the notice on Schedule 14N in reliance on state or foreign law or a company's governing documents must be provided to the company by the date set forth in the company's advance notice provision or, in

the absence of such a provision, no later than 120 calendar days before the anniversary of the date the company mailed its proxy materials for the prior year's annual meeting. If the 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 prior year, then the nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials. In these situations, the company will be required to disclose the date by which the shareholder must submit the required notice on a new Item 5.08 of Form 8-K within four business days after the company determines the anticipated meeting date.

What information must a shareholder include in the notice on Schedule 14N when a nomination is made pursuant to state or foreign law or the company's governing documents?

The information required to be included in the notice on Schedule 14N for purposes of nominations made pursuant to state or foreign law or the company's governing documents is somewhat less expansive than the information required for nominations made pursuant to Rule 14a-11. In particular, a nominating shareholder would not be required to certify or represent (1) its intention to continue to hold the qualifying amount of securities through the shareholder meeting or its intent with respect to continued ownership after the election, (2) that its shares are not held for the purpose, or with the effect, of changing control of the company or gaining more than the maximum number of board seats provided for under Rule 14a-11, (3) the independence of the nominee or (4) whether the nominee meets the director qualifications set forth in the company's governing documents. However, the notice on Schedule 14N will require the following information—

- the name and address of the nominating shareholder or each member of the nominating shareholder group
- the amount and percentage of securities held by the nominating shareholder or group members and entitled to vote on the election of directors at the meeting and the voting power derived from the securities that have been loaned or sold in a short sale that remains open.

The following material must be included not only in the Schedule 14N, but also in the company's proxy statement—

- a statement from the nominee that the nominee consents to be named in the company's proxy materials and to serve on the company's board, if elected
- disclosure about the nominee complying with the requirements of Items 4(b), 5(b) and 7(a), (b) and (c) of Schedule 14A
- disclosure about the nominating shareholder or each member of a nominating shareholder group as would be required under Items 4(b) and 5(b) of Schedule 14A in a contested election
- disclosure about whether the nominating shareholder or any member of a nominating shareholder group has been involved in certain legal proceedings during the past 10 years
- the following information regarding the nature and extent of the relationships between the nominating shareholder or nominating shareholder group, the nominee and/or the company or any affiliate of the company—
 - any direct or indirect material interest in any contract or agreement between the nominating shareholder or any member of the nominating shareholder group, the nominee and/or the company or any affiliate of the company (including any employment agreement, collective bargaining agreement or consulting agreement)
 - any material pending or threatened litigation in which the nominating shareholder or any member of the nominating shareholder group and/or nominee is a party or a material participant, involving the company, any of its executive officers or directors or any affiliate of the company
 - any other material relationship between the nominating shareholder or any member of the nominating shareholder group, the nominee and/or the company or any affiliate of the company not otherwise disclosed.
- any Web site address on which the nominating shareholder or nominating shareholder group may publish soliciting materials.

What information must the company include in its proxy statement when a shareholder nomination is made pursuant to state or foreign law or a company's governing documents rather than Rule 14a-11?

Companies must include certain information in their proxy statements when shareholder nominees are included in the company's proxy materials pursuant to procedures established under state or foreign law or the company's governing documents. For a list of the required information, see the second part of the answer to the immediately preceding question.

What are the advantages and disadvantages of nominating a director under state or foreign law or a company's governing documents instead of under Rule 14a-11?

A shareholder using provisions under state or foreign law or a company's governing documents to require the inclusion of shareholder nominees in the company's proxy materials will not be subject to, among other things, Rule 14a-11's limitations on the number of nominees that can be included in the company's proxy statement, requirements regarding ownership and holding period or the mechanism for determining priority of shareholder nominees to be included in the company's proxy materials, unless such provisions are included under state or foreign law or the company's governing documents. Shareholders submitting nominees for inclusion in a company's proxy materials under state or foreign law or the company's governing documents will not, however, be entitled to the safe harbors available for nominating shareholders under Rule 14a-11. Specifically, the rule changes relating to eligibility to file a Schedule 13G, as discussed below, do not apply to shareholders nominating a director under state or foreign law or a company's governing documents, nor do the exemptions from the federal proxy rules for certain communications in connection with forming a nominating shareholder group or relating to solicitation in support of shareholder nominees as discussed above. In addition, a company would not be required to include the 500-word statement of support in its proxy statement unless it is separately required to do so under state or foreign law or the company's governing documents.

BENEFICIAL OWNERSHIP REPORTING BY NOMINATING SHAREHOLDERS AND GROUPS

Will use of the proxy access rules affect eligibility to file on Schedule 13G?

To be eligible to file a beneficial ownership report on Schedule 13G, a shareholder filing pursuant to Rule 13d-1(c) as a passive investor or pursuant to Rule 13d-1(b)(1) as a qualified institutional investor must have acquired the securities without the purpose or effect of changing or influencing control of the company or in connection with, or as a participant in, any transaction having that purpose or effect. In addition, qualified institutional investors must have acquired the securities in the ordinary course of their business. The SEC is amending these provisions so that activities solely in connection with a nomination under Rule 14a-11 will not result in a loss of eligibility to file on Schedule 13G.¹⁷ The rule change and instructions do not elaborate on what constitutes "activities solely in connection with a nomination under Rule 14a-11," other than to state that this exception will not be available after the election of a director nominated pursuant to Rule 14a-11. However, in the adopting release, the SEC stated, "we believe that the formation of a shareholder group solely for the purpose of nominating one or more directors pursuant to proposed Rule 14a-11, the nomination of one or more directors pursuant to proposed Rule 14a-11, or soliciting activities in connection with such a nomination (including soliciting in opposition to a company's nominees), should not result in a nominating shareholder or nominating shareholder group losing its eligibility to file on Schedule 13G."¹⁸ Although the SEC is amending the eligibility requirements for filing on Schedule 13G in connection with the formation of a nominating shareholder group, existing SEC rules and interpretations continue to apply when determining whether shareholders have formed a group for purposes of Regulation 13D-G. Often these concepts are used in determining group status for purposes of poison pills, state takeover statutes and change of control provisions.

These rule changes do not apply to nominating shareholders or groups that submit a nomination pursuant to an applicable state or foreign law provision or a company's governing documents, because, in those instances, the applicable provisions may not limit the number of board seats for which a shareholder or group could nominate candidates or include a requirement that the nominating shareholder or group lack intent to change the control of the issuer or to gain more seats on the board

¹⁷ Interestingly, the SEC did not adopt a similar amendment to Rule 13d-1(e)(1)(i), which requires a Schedule 13G filer to switch to a Schedule 13D if the person changes its investment intent and "holds the securities with a purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect." This appears to merely have been an oversight.

¹⁸ Adopting release at 245.

than the maximum provided for under the new rule, as is the case under Rule 14a-11. Submitting a nomination pursuant to an applicable state or foreign law provision or a company's governing documents does not necessarily require the shareholder to switch from a Schedule 13G to a Schedule 13D, but it does require nominating shareholders or groups to make a fact-specific determination of whether a Schedule 13D filing is required.

Will a nominating shareholder group be subject to Section 16 reporting requirements if its members collectively own more than 10 percent of a company's shares?

Yes. The SEC did not amend the Section 16 reporting requirements. Consequently, a group formed for the purpose of nominating a director pursuant to Rule 14a-11, soliciting in connection with the election of that nominee or having that nominee elected as a director will be analyzed the same way as any other group for purposes of determining whether group members are 10 percent owners subject to Section 16. In 2003, the SEC had proposed an exclusion from Section 16 reporting for such groups, but the SEC does not believe that an exclusion is necessary under the new rules because the ownership threshold for Rule 14a-11 is significantly lower than 10 percent. The SEC also did not adopt any standards for establishing the independence of the nominee from the nominating shareholder or members of the nominating shareholder group that would address concerns that a nominating shareholder could be deemed a "director by deputization" for Section 16 purposes if its nominee were elected to the board.

CONSIDERATIONS FOR PUBLIC COMPANIES

Should public companies take any actions now in response to the new proxy access rules?

Public companies should consider the following possible courses of action at this time—

- **Size of Board.** Companies may wish to consider adjusting the size of their board of directors in light of the new rules. The new rules would permit nominating shareholders to nominate one director or up to 25 percent of the board, whichever is greater. If the 25 percent cap does not result in a whole number, the maximum number of directors that could be nominated will be rounded down. For example, if the company's board consists of 12, 13, 14 or 15 directors, the company is only required to include three shareholder nominees in its proxy statement.
- **Advance Notice Bylaws.** Companies should review their bylaws in light of the new rules and revise them as necessary to address any potential conflicts. If a company decides to amend its bylaws in this regard, care should be taken to ensure that the bylaws adequately clarify the extent to which such bylaw provision is intended to apply to proposals submitted under an applicable proxy rule or another independent procedure in light of court decisions narrowly construing advance notice bylaw provisions.¹⁹
- **Shareholder Relationships.** Good shareholder relations will be increasingly important as we enter into this new regime of proxy access. Companies should examine their shareholder base and take steps to improve relationships with, and communications to, their shareholders (within the limits of Regulation FD). Shareholders may be less likely to demand representation on the board of directors if a company's board and management listens and reacts to shareholder concerns and suggestions.
- **Board Preparation.** Companies need to educate their nominating committees and boards on the new proxy access rules and how the rules will likely impact the company. Nominating committees and boards will need to ensure they are prepared to handle the new proxy access process in the event the company receives shareholder nominees under the new rules.

Are legal challenges likely to be made to the proxy access rule?

Since the SEC proposed Rule 14a-11 in 2009, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted, which gave the SEC explicit authority to adopt proxy access rules under terms and conditions that the SEC determines are appropriate. Despite this specific authorization, the SEC's proxy access rules may be subject to legal challenges due to alleged deficiencies in the SEC's statistical evidence and its stated justification for adopting the rules, as referenced in the

¹⁹ See *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, No. 3447 (Del. Ch. Mar. 13, 2008).

statements by commissioners Kathleen Casey and Troy Paredes at the SEC's open meeting on August 25, 2010. Further, the U.S. Chamber of Commerce has reportedly retained legal counsel to review the new rules for a potential legal challenge.

How will the new proxy access rules affect the 2009 amendments to the Delaware General Corporation Law?

In 2009, Delaware amended its General Corporation Law to expressly allow (but not require) Delaware corporations to adopt bylaws that give shareholders the right to include their nominees for director in the corporation's proxy materials, subject to such lawful procedures and conditions as the bylaws may impose. Delaware's approach gives corporations incorporated in that state flexibility in deciding whether and under what conditions shareholders should have access to the company's proxy.

Because Rule 14a-11 creates a right to proxy access that essentially is independent of any state or foreign law or bylaw requirements,²⁰ a corporation's shareholders will, in any event, have their right to proxy access under Rule 14a-11, regardless of whether the corporation has bylaw provisions allowing proxy access. The new rules, however, do contemplate that corporations could adopt bylaws providing additional methods by which shareholders could nominate directors, so long as the methods do not conflict with Rule 14a-11. In these situations, the nominations must be made pursuant to new Rule 14a-18, and the nominating shareholder will still be required to file a Schedule 14N containing the information required for a nomination made pursuant to state or foreign law or a company's governing documents. Because Rule 14a-11 essentially provides a "one size fits all" approach to proxy access, it largely renders superfluous state or foreign laws that allow companies more flexibility in crafting proxy access provisions that may better suit their needs.

CONTACT INFORMATION

If you have questions regarding this alert, please contact—

Patrick J. Dooley
pdooley@akingump.com
212.872.1080
New York

Christine B. LaFollette
clafollette@akingump.com
713.220.5896
Houston

Seth R. Molay
smolay@akingump.com
214.969.4780
Dallas

C.N. Franklin Reddick III
freddick@akingump.com
310.728.3204
Los Angeles

²⁰ Subject to the rare or nonexistent situation where state or foreign law does not permit nominations of directors by shareholders.