

INVESTMENT FUNDS ALERT

PROPOSAL WOULD SUBJECT REGISTERED INVESTMENT COMPANIES TO NEW PROXY ACCESS REGIME

On June 10, 2009, the Securities and Exchange Commission (SEC) unveiled the details of its proposal to allow shareholders to have their director nominees included in the proxy materials of investment companies registered with the SEC under the Investment Company Act of 1940 (the “Company Act”) and issuers with a class of equity securities registered under the Securities Exchange Act of 1934 (the “Exchange Act”).¹ The controversial proposal, which passed by a 3-2 vote of the commissioners at the SEC’s May 20, 2009, open meeting would allow a shareholder (or group of shareholders) who owns at least 1 percent of the stock of a registered investment company that has a net asset value (NAV) of \$700 million or more or a business development company or other subject issuer that is a large accelerated filer² (or 3 percent and 5 percent for registered investment companies with smaller NAVs or smaller companies³, respectively) and who has held the shares for at least one year, 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. If adopted, the proposal would dramatically change the landscape for the election of directors of registered investment companies.

The proposal is subject to a 60-day comment period ending on August 17. In this alert, we answer some key questions about the proposal as it applies to registered investment companies and business development companies (BDCs).⁴

¹ SEC Rel. Nos. 33-9046; 34-60069, “Facilitating Shareholders Director Nominations” (June 10, 2009) (“Proposing Release”).

² A large accelerated filer is an issuer that (i) had an aggregate worldwide market value of voting and nonvoting common equity held by non-affiliates of \$700 million or more, as of the last business day of the issuer’s most recently completed second fiscal quarter; (ii) has been subject to the requirements of Section 13(a) or 15(d) of the Securities Exchange Act for at least 12 months; and (iii) has filed at least one annual report with the SEC.

³ The ownership thresholds for business development companies are determined in a similar manner as companies with a class of equity securities registered under the Exchange Act.

⁴ For details on the application of the proposed proxy access to publicly traded companies, see the alert that Akin Gump Strauss Hauer & Feld LLP published on June 22, 2009, “[SEC Releases Proxy Access Proposal](#).”

COMPANIES AND MEETINGS SUBJECT TO THE PROPOSED RULES

Which companies would be subject to the proposed rules?

The proposed proxy access rules would apply to all companies that were previously subject to the proxy rules, including companies that have a class of securities registered pursuant to Section 12 of the Exchange Act and investment companies registered under Section 8 of the Company Act.⁵

Which shareholder meetings would be subject to the proposed rules?

The proposed rules would require 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 would not be subject to the proxy access rules.⁶

SHAREHOLDER ELIGIBILITY REQUIREMENTS

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

Under proposed Rule 14a-11, shareholders would have access to include their director nominees in registered investment company proxy materials based on a sliding scale of share ownership in relation to the size of the company set forth below. For all companies, the shareholder must have held the shares that are used for purposes of meeting the ownership threshold continuously for at least one year as of the date the shareholder gives the company notice of its nominees and must intend to continue to own the requisite shares through the date of the shareholder meeting.

Registered Investment Companies (other than BDCs)⁷ Net Asset Value	Other Issuers (including BDCs) Type of Company	Percentage of Stock That Must Be Owned At Least One Year
\$700 million or more	Large Accelerated Filer	1 percent
\$75 million to less than \$700 million	Accelerated Filer ⁸	3 percent

⁵ The proposed proxy rules would not apply to those companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12.

⁶ It is unclear how these proposed rules would apply to entities that are not required to have an annual meeting under state law or the listing requirements of a securities exchange and have called a special meeting of the shareholders to fill a limited number of vacancies on the board of directors.

⁷ The NAV of a registered investment company would be the NAV as disclosed on the company's Form N-CSR (unless the investment company is a series company) as of the end of the company's second fiscal quarter of the year immediately before the fiscal year of the meeting.

⁸ An accelerated filer is an issuer that otherwise meets the requirements for a large accelerated filer except that its public float is \$75 million or more but less than \$700 million and it is not eligible to file reports as a smaller reporting company.

Registered Investment Companies (other than BDCs) ⁷ Net Asset Value	Other Issuers (including BDCs) Type of Company	Percentage of Stock That Must Be Owned At Least One Year
Less than \$75 million	Non-accelerated Filer	5 percent

Is the net asset value determined on a series basis or an issuer basis, and, if it is determined on an issuer basis, how can a shareholder determine the net asset value of a series company?

The ownership requirements are determined on an issuer by issuer basis. A registered investment company that is a series company would be required to file a current report on Form 8-K on new Item 5.07 within four business days after determining the anticipated meeting date to report (1) the investment company's net assets as of June 30 of the calendar year immediately preceding the calendar year of the meeting and (2) the total number of outstanding shares issued and eligible to be voted as of the end of the most recent calendar quarter.

Can shareholders form groups to satisfy the share ownership requirement?

Yes. Shareholders would 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 one-year holding requirement.

How would a shareholder determine whether the number of shares it owns meets the ownership threshold?

In determining the number of shares that are entitled to be voted on the election of directors, a nominating shareholder would, unless the nominating shareholder knows or has reason to know that such information is inaccurate, be permitted to rely on information set forth in the following—

- in the case of a registered investment company other than a series company, the company's most recent annual or semiannual report on Form N-CSR
- in the case of a series company, the current report on Form 8-K described above
- in the case of a BDC, in the BDC's most recent quarterly or annual report or any subsequent current report filed with the SEC.

Are there any other eligibility requirements for nominating shareholders?

Although not technically listed as an eligibility requirement, a nominating shareholder would be required to certify that it is not holding the shares for the purpose of, or with the effect of, changing control of the issuer or gaining more than a limited number of seats on the board. Consequently, the proposed rules are not intended to facilitate a change in control of a company. It should be noted, however, that a nominating shareholder could later change its mind. The SEC has solicited comment on how the rules should address the possibility that a nominating shareholder's or group's intent may change over time.

NUMBER OF NOMINEES

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

A company would 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 proposed Rule 14a-11, and the term of that director extends past the date of the meeting of shareholders for which the company is soliciting proxies for the election of directors, the company would 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. Therefore, for companies with classified boards, the maximum number of directors elected under the new procedures that could be serving on the board at any one time is 25 percent of the company's board or one shareholder nominee, whichever is greater.

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 would be those put forward by the nominating shareholder or group that first provides timely notice to the company. If the first nominating shareholder or group does not nominate the maximum number of directors allowed under the rule, then the nominee or nominees of the next nominating shareholder or group from which the company receives timely notice will be included, up to the maximum number of shareholder nominees required to be included by the company.

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 would be required to include in its proxy materials would 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 would only be required to include three shareholder nominees in its proxy statement.

SHAREHOLDER NOMINEE REQUIREMENTS

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

Yes. Nominees would need to satisfy three requirements:

- **Non-Interested Person.** A nominee for a registered investment company or BDC board could not be an "interested person" of such company as defined in Section 2(a)(19) of the Company Act.
- **No violation of law or company governing documents.** A company would not be required to include in its proxy materials any shareholder nominee whose candidacy or, if elected, board membership would violate applicable state or federal law, any rules of the national securities exchange or national

securities association to which the company is subject or the company's governing documents. However, in the proposing release, the SEC states that, if a company's governing documents permit the inclusion of shareholder nominees in the company's proxy materials but impose more restrictive eligibility standards or mandate more extensive disclosures than those required by the proposed rules, the company could not exclude a nominee on the grounds of failure to meet the more restrictive standards included in the company's governing documents. "In other words, companies may not opt out of Rule 14a-11 by adopting alternate requirements for inclusion of shareholder nominees for director in the company's proxy materials."⁹

- **No agreement with company regarding nomination.** Finally, neither the nominee nor the nominating shareholder (or any member of the nominating group) would be allowed to have an agreement with the company or an affiliate of the company regarding the nomination. This requirement, which is set forth in the form of a representation that the nominating shareholder or group must make, 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 proposed rule clarify that (1) negotiations with a company's nominating committee or board to have a nominee included in management's slate, where those negotiations are unsuccessful, or (2) negotiations limited to whether the company is required to include a shareholder nominee in the company's proxy materials under the proposed rules, would not be deemed an agreement for purposes of the rules.

Under the proposed rules, there would be no 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.

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

No. The instruction to the proposed rule contains a safe harbor making clear that a nominating shareholder will not be deemed an affiliate of the company solely as a result of nominating a director or soliciting for the election of such director nominee or against a company nominee pursuant to the rule. Also, if a shareholder nominee is elected and the nominating shareholder or group does not have an agreement or relationship with that director, other than relating to the nomination, the nominating shareholder or group would not be deemed an affiliate solely by virtue of such nomination.

SOLICITING ACTIVITIES BY NOMINATING SHAREHOLDERS

Would 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 is proposing to exempt communications in connection with the formation of these groups from most of the

⁹ Proposing Release at 62 n. 152.

federal proxy rules. Specifically, any written (but not oral)¹⁰ solicitation by, or on behalf of, a shareholder 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 that require the filing of a proxy statement with the SEC,¹¹ provided that (1) any written soliciting material 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 shares beneficially owned by the shareholder or shareholder group; and the means by which shareholders may contact the soliciting shareholder; and (2) such written soliciting material is filed under cover of Schedule 14A with the SEC and sent to each national securities exchange on which any class of securities of the company is listed no later than the date the communication is first sent to shareholders. Although these communications would be exempt from most of the proxy rules, they would remain subject to the antifraud provisions of Rule 14a-9.

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

Written solicitations (but not oral solicitations) by, or on behalf of, a nominating shareholder or nominating shareholder group in support of a nominee included in the company's proxy materials pursuant to proposed Rule 14a-11 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, 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 a form of proxy or revocation; (2) each written communication identifies the nominating shareholder and his direct or indirect interests, by security holdings or otherwise, and includes a legend advising shareholders about the company's proxy statement; and (3) such material is filed under cover of Schedule 14A 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 sent to shareholders.

NOTICE AND DISCLOSURE REQUIREMENTS

How would shareholders nominate candidates under the proposed rules?

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

¹⁰ The SEC states in the Proposing Release that the exemption would not be available for oral solicitations. Proposing Release at 115 and 119. As drafted, however, the exemption appears to apply to "any solicitation" with a requirement that any written solicitation be limited to the matters set forth in the rule and be filed with the SEC. Proposing Release at 214. This is in contrast to the exemption for soliciting activities in support of a nominee, which is clearly limited to "written solicitations." Proposing Release at 215.

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.

When would the notice have to be provided?

The notice would have to be provided to the company and filed with the SEC by the date specified by the company's advance notice provision or, where no such provision is in place, no later than 120 calendar days before 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 must provide notice a reasonable time before the company mails its proxy materials. In these situations, the company (including a registered investment company) would be required to disclose the date by which the shareholder must submit the required notice on a Form 8-K within four business days after the company determines the anticipated meeting date.

The proposed rule does not set an outside date for the submission of nominees, unlike most advance notice bylaws, which typically require that nomination notices be given within a specified range of time, usually a 30-day window that ends well in advance of the meeting date. The SEC has solicited comment on whether a time range should be imposed. Because shareholder nominees are included in the company's proxy materials on a "first come, first served" basis, the absence of an outside date for shareholder submissions may result in a rush by shareholders to make submissions immediately after (or conceivably even before) an annual meeting for the next annual meeting. But, setting an outside date for submissions when nominees are accepted on a "first in time" basis may also be problematic in determining which submission was received first, if the company receives multiple submissions on the first day of the submission period.

What information would be required in the notice on Schedule 14N in the case of registered investment companies and business development companies?

The notice on Schedule 14N would 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 beneficially owned by the nominating shareholder or group members
- a statement from the "record" holder of the shares beneficially owned by the nominating shareholder or each member of the nominating shareholder group verifying that, as of the date of the shareholder notice on Schedule 14N, the shareholder continuously held the securities being used to satisfy the ownership threshold for at least one year (this requirement applying only where the nominating shareholder is not the registered holder of the shares)¹²
- a statement that the nominating shareholder or each group member intends to continue to own the requisite shares through the shareholder meeting, and disclosure of their intent with respect to continued ownership after the election

¹² If the company is a business development company, this requirement would not apply where the shareholder has not filed a Schedule 13D, Schedule 13G or Form 3, 4 or 5.

- a certification that, to the best of their knowledge and belief, the shares are not held for the purpose of, or with the effect of, changing the control of the issuer or gaining more than a limited number of seats on the board of directors
- a representation that the nominating shareholder or group is eligible to submit a nominee under Rule 14a-11
- a representation that, to the knowledge of the nominating shareholder or group, the candidate's nomination or initial service on the board, if elected, would not violate controlling state law, federal law or applicable listing standards (other than a standard relating to independence)
- a representation that, to the knowledge of the nominating shareholder or group, the nominee is not an interested person
- a representation that neither the nominee nor the nominating shareholder (nor any member of the nominating shareholder group, if applicable) has an agreement with the company regarding the nomination of the nominee.

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 board if elected
- a statement that the nominating shareholder or group intends to continue to own the requisite amount of securities through the date of the meeting, as well as a statement regarding their intent with respect to continued ownership after the election
- disclosure about the nominee complying with the requirements of Items 4(b) (information about persons making solicitation); 5(b) (interests of persons making solicitation); 22(b) (information regarding registered investment company directors) of Schedule 14A; and, in the case of a business development company, 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)
- disclosure about the nominating shareholder or members 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 member of a nominating shareholder group has been involved in certain legal proceedings during the past five years
- the following information regarding the nature and extent of the relationships between the nominating shareholder or group and nominee and the company or any affiliate of the company—

- any direct or indirect material interest in any contract or agreement between the nominating shareholder or group or the nominee and 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 group or nominee is a party or a material participant and that involves the company, any of its officers or directors, or any affiliate of the company
- any other material relationship between the nominating shareholder or group or the nominee and 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 or nominees, which may not exceed 500 words.

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

Schedule 14N would need to be amended promptly if any material change occurs in the facts set forth in the schedule. Also, an amended Schedule 14N would have to 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 concerning continued ownership of their shares.

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

The company would be required to include in its proxy materials a disclosure concerning the nominating shareholder and the shareholder nominee or nominees 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 would be required in the notice on Schedule 14N?”

What would the company be required to include in the form of proxy?

The company would be required to identify the shareholder nominees as such in the company’s form of proxy. However, the company would be permitted to recommend whether shareholders should vote for or against or withhold votes on those nominees and could continue to recommend that shareholders vote for management nominees. If a shareholder nominee is included in the proxy, the company could not use the current practice of providing shareholders the option of voting for, or withholding authority to vote for, management nominees as a group. Instead, each nominee would have to be voted on separately. Companies could continue to solicit discretionary authority to vote a shareholder’s shares for the company’s nominees, as well as cumulate votes for company nominees in situations where there is cumulative voting.

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

No. The company would not be responsible for any such information unless the company knows or has reason to know that the information is false and misleading.

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

No. The rules would 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 the proxy rules.

Under what circumstances could a company exclude a shareholder nominee?

A company could determine that it is not required under proposed 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—

- Proposed Rule 14a-11 is not applicable to the company.
- The nominating shareholder or group has not complied with the requirements of Rule 14a-11.
- The nominee does not meet the requirements of Rule 14a-11.
- Any representation required to be included in the notice to the company is false or misleading in any material respect.
- The company has received more nominees than it is required to include under proposed Rule 14a-11.

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

To exclude a nominee, a company would 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 would send a notice to the SEC when it determines not to include a shareholder nominee in its proxy materials, and the company could 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
Date set by company's advance notice provision or, in the absence of such a provision, 120 days before the anniversary of the date that the company mailed the prior year's proxy materials	Nominating shareholder or group must provide to company and file with SEC notice on Schedule 14N.
Within 14 calendar days after the company's receipt of the nominating shareholder's or group's notice on Schedule 14N	Company must notify the nominating shareholder or group of its determination not to include the nominee or nominees and explain the basis for its determination (this notification is referred to as a "deficiency notice").
Within 14 calendar days after the nominating shareholder's or group's receipt of the company's deficiency notice	Nominating shareholder must respond to the company's deficiency notice and may correct any eligibility or procedural deficiencies ¹³ .
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC ¹⁴	Company must provide notice to the SEC and the nominating shareholder or group if it still intends to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination.
Within 14 calendar days of the nominating shareholder's or group's receipt of the company's notice to the SEC	Nominating shareholder or group could submit a response to the company's notice to the SEC.
As soon as practicable after receipt of the company's notice	SEC staff would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group.
No later than 30 calendar days before the company files its definitive proxy statement and form of proxy with the SEC	Company must provide the nominating shareholder or group with notice of whether it will include or exclude the shareholder's nominee or nominees.

For an alternate presentation, see the flow chart set forth in Annex A.

PROPOSED CHANGES TO RULE 14A-8 – THE SHAREHOLDER PROPOSAL RULE

How is the SEC proposing to amend Rule 14a-8?

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 proposing to change 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 that do not conflict with proposed Rule 14a-8, other SEC proxy rules or applicable law. Only shareholders who meet the current eligibility requirements of Rule 14a-8 (which require that the shareholder own at least \$2,000 in market

¹³ 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.

¹⁴ SEC staff could permit the company to make its submission later than 80 days if it demonstrates good cause for missing the deadline.

value or 1 percent, whichever is less, of the company's shares for at least one year) could submit such proposals.

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

Why is the SEC proposing to amend Rule 14a-8?

The SEC wants to allow shareholders the flexibility of proposing amendments that would establish procedures for nominating directors and disclosures related to such nominations that would serve as methods additional to Rule 14a-11 for accessing the company's proxy. Any such shareholder proposals would be permitted so long as they do not either 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.

What prior staff interpretations is the SEC proposing to codify in Rule 14a-8?

Although the SEC is proposing to amend 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 otherwise provided for in the proxy rules. Therefore, the SEC is proposing to amend Rule 14a-8(i)(8) to make clear that a company would be permitted to 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
- nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision or a company's governing documents; or
- otherwise could affect the outcome of the upcoming election of directors.

NOMINATIONS PURSUANT TO STATE LAW OR COMPANY GOVERNING DOCUMENTS

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

As contemplated by Rule 14a-8, state 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 law or a company's governing documents would be required to give notice of its intent on a Schedule 14N and file the notice with the SEC.

When would the notice on Schedule 14N be provided?

The notice would have to be provided by the same deadline required for a notice made in reliance on Rule 14a-11, which is the date set forth in the company's advance notice provision or in the absence of such a provision, no later than 120 days before the date the company mailed its proxy materials for the prior year's annual meeting.

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

The information required to be included in the notice on Schedule 14N for purposes of nominations made pursuant to state 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, unless required by state law or the company's governing documents, a nominating shareholder would not be required to certify or represent (1) its intention to continue to own the shares through the shareholder meeting or to continue to own the shares after the election; (2) that its shares are not held for the purpose of, or with the effect of, changing the control of the issuer or gaining more than a limited number of seats on the board; (3) that the nominee is not an interested person; or (4) that neither the nominee nor the nominating shareholder has an agreement with the company regarding the nomination. However, the notice on Schedule 14N would 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 beneficially owned by the nominating shareholder or group members.
- 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 22(b) of Schedule 14A and, in the case of a business development company, Items 7(a), (b) and (c)
- disclosure about the nominating shareholder or members of a nominating shareholder group, as would be required under Items 4(b) and 5(b) of Schedule 14A
- disclosure about whether the nominating shareholder or any member of a nominating shareholder group has been involved in certain legal proceedings during the past five years
- the following information regarding the nature and extent of the relationships between the nominating shareholder or nominating shareholder group and nominee and the company or any affiliate of the company:
 - any direct or indirect material interest in any contract or agreement between the nominating shareholder or nominating shareholder group or the nominee and 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 nominating shareholder group or nominee is a party or a material participant, involving the company, any of its officers or directors, or any affiliate of the company
 - any other material relationship between the nominating shareholder or nominating shareholder group or the nominee and the company or any affiliate of the company not otherwise disclosed
 - the Web site address on which the nominating shareholder or nominating shareholder group may publish soliciting materials, if any.

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

To provide shareholders with full and fair disclosure of information that is material to a director election decision, the SEC is proposing that 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 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.

CONSIDERATIONS FOR INVESTMENT COMPANIES

Should registered investment companies and BDCs take any actions now in response to the proxy access proposal?

Registered investment companies and BDCs should consider several possible courses of action at this time:

- **Comment on Proposal.** Registered investment companies and BDCs should consider whether they want to submit comments on the proposal. Already, several business groups have criticized the proposal, while various institutional investor groups have applauded the proposal as long overdue. The SEC has solicited comment on almost every aspect of the proposal and is expected to take action on final rules before the 2010 proxy season. Input from companies and other interested parties will likely help shape the final form of these rules.
- **Size of Board.** Companies may wish to consider adjusting the size of their board of directors in light of the proposal. The proposal 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 would be rounded down. Because the proposal rounds down, the size of a company's board could affect the impact this proposal has on the company.
- **Advance Notice Bylaws.** Most companies with advance notice bylaws, such as closed-end funds and BDCs, can likely wait until final rules are adopted before amending their advance notice bylaws to accommodate the new rules. However, closed-end funds or BDCs with annual meetings scheduled in the early part of 2010 may wish to consider amending their advance notice bylaws prior to the SEC's adoption of final rules to ensure that they will have adequate time to address any shareholder nominations that are received for the 2010 annual meeting. Many closed-end funds or BDCs have bylaws that require shareholders to submit their nominees for director at least 90 or 120 days in advance of the meeting date for the prior year's annual meeting. The proposed deadline under Rule 14a-11 is the date established by the company's advance notice bylaw or, in the absence of such a bylaw, 120 days before the anniversary of the mailing date of the prior year's proxy materials (which would typically be 150 to 165 days before the meeting). Also, the proposed procedure for seeking to exclude a shareholder nominee under Rule 14a-11, where the company seeks a no-action letter from the SEC, could take almost 120 days under the SEC's proposed timetable.

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 recent court decisions narrowly construing advance notice bylaw provisions.¹⁵ In addition, a company that amends its bylaws to lengthen the timing of the advance notice provision should be sensitive to state law, which might consider such longer periods to be unreasonable.

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

Although the SEC no doubt will receive many comments, both favorable and unfavorable, on the proposal, potential legal challenges to the proposal are likely to center on whether the SEC has the authority to promulgate proxy access rules and pre-empt state law in this area. Critics are expected to argue that the SEC's proposed rules grant shareholders a substantive right to direct access to the company's proxy statement—a right

¹⁵ See *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, No. 3447 (Del. Ch. Mar. 13, 2008).

they do not necessarily have under state law¹⁶—and, thus, the rules go beyond mere procedural requirements and constitute an unprecedented pre-emption of state law. Also at issue will be whether the SEC’s authority under Section 14(a) of the Securities Exchange Act of 1934—which authorizes the SEC to create rules and regulations pertaining to the solicitation of proxies—extends to the creation of shareholder rights to access the company’s proxy statement for purposes of director elections.¹⁷

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¹⁶ In 2007, North Dakota amended its corporate code to permit 5 percent shareholders to provide a company notice of intent to nominate directors and require the company to include such shareholder nominee(s) in the company’s proxy materials. As discussed more fully below, in response to *CA, Inc. v. AFSCME*, 953 A.2d 227 (Del. 2008), Delaware recently amended the Delaware General Corporation Law to expressly allow (but not require) Delaware corporations to adopt bylaws that give shareholders the right to include shareholder nominees in the corporation’s proxy materials. Consequently, shareholders of a Delaware corporation can amend bylaws to provide for proxy access, but the recent amendments to Delaware law do not give shareholders a direct right to proxy access.

¹⁷ Legislation recently introduced in Congress, if passed, could address these issues at least in part. Sens. Charles Schumer and Maria Cantwell have introduced broad shareholder rights legislation that, among other things, would authorize and require the SEC to adopt proxy access rules. Separately, Rep. Gary Peters recently introduced a bill in the House of Representatives that would give proxy access to shareholders who have held at least 1 percent of a company’s stock for at least a year.