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SEC Adopts Final Rules to Enhance Shareholder Access to Companies' Proxy Materials

On August 25, the Securities and Exchange Commission adopted final rules, effective 60 days following publication of the rules in the Federal Register (expected shortly), which facilitate the ability of shareholders of a public company to nominate candidates for election as directors in opposition to the board's recommended nominees. New Rule 14a-11 requires that public companies include in their proxy materials director nominees proposed by shareholders who meet the criteria described below. In addition, the SEC amended Rule 14a-8(i)(8) to permit shareholders to include in the company's proxy materials proposals to amend, or request the amendment of, the company's governing documents with respect to procedures for nominating directors. By eliminating the cost to nominating shareholders of soliciting proxies for a partial opposition slate, these rules will effectively remove significant cost barriers to proxy contests.

The new rules are the culmination of many years of debate concerning the appropriateness of granting shareholders direct access to a company's proxy statement for shareholder director nominees. The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act expressly confirmed the SEC's authority to adopt rules addressing proxy access, and in the view of the SEC, resolved questions raised in the past with respect to such authority.

Click [here](#) for the Final Rule Release No. 33-9136.

Applicability of Rule 14a-11

Rule 14a-11 applies to all public companies that are required to file reports under the Securities Exchange Act of 1934, including registered investment companies, other than companies that are subject to proxy rules solely because they have a class of debt securities registered under the Exchange Act. However, Rule 14a-11 will not apply to "smaller reporting companies" (generally, a company with a public equity float of less than \$75 million) until three years after its effective date. Rule 14a-11 also will not apply when applicable state or foreign law or a company's governing documents prohibit shareholders from nominating a candidate for election as a director.

Shareholder Criteria

In order to take advantage of enhanced proxy access, the shareholder, or group of shareholders, must meet the following requirements with respect to the number of shares held and the length of time that such shares have been held:

Minimum Ownership Threshold

The shareholder, or group of shareholders, must own 3% of the voting power of the company's shares that are entitled to vote on the election of directors. Such shareholder, or member of a group of shareholders, must hold the power to dispose of, and the power

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to vote, such shares, and such power will not be deemed to exist over shares that a nominating shareholder or member of a nominating shareholder group merely has the right to acquire.

In addition, any shares that a nominating shareholder has sold in a short sale or borrowed for any reason other than for a short sale cannot be counted toward the “Minimum Ownership Threshold.” However shares that have been loaned by a nominating shareholder to a third party can be counted toward the “Minimum Ownership Threshold” if the nominating shareholder can recall such shares, and will recall such shares upon notification that the shareholder’s nominees will be included in the company proxy statement and proxy card.

Continuous Ownership Threshold

With respect to shares used to satisfy the “Minimum Ownership Threshold,” the shareholder, or group of shareholders, must:

- (a) have continuously owned such shares for at least three years prior to the date that it notifies the company of its intent to nominate a director; and
- (b) intend to continue to own such shares through the date of the annual or special meeting.

Notice and Disclosure Requirements

In order to include their nominees in the company’s proxy materials, shareholders must provide to the company, and file with the SEC, notice of their intent no earlier than 150 days, and no later than 120 days, before the anniversary of the date that the company mailed its proxy materials for the prior year’s annual meeting.

The aforementioned notice would be filed with the SEC and submitted to the company on a new Schedule 14N, on which each nominating shareholder, including all members of a nominating shareholder group, must:

- Represent that the nominee for directorship meets the director independence standards of the applicable national securities exchange;
- Represent that, to the best of its knowledge, the nominee meets the director qualification standards set forth in the company’s governing documents;
- Represent that the nominee’s candidacy and board membership would not violate applicable law or rules of the applicable national securities exchange;
- Represent that there is no agreement between the company and the shareholder, or any member of the shareholder group, with respect to the nomination;
- Disclose information regarding any relationships between the nominating shareholder or group, the nominee, and/or the company or its affiliates;
- Represent that the shareholder or group is not attempting to effect a change of control of the company or to nominate more than one director or 25% of the company’s board, whichever is greater;
- Represent that the shareholder, or shareholder group, satisfies both the “Minimum Ownership Threshold” and the “Continuous Ownership Threshold”;
- Disclose the intent of the shareholder or group with respect to continued ownership of the company’s shares following the annual meeting (or special meeting in lieu of an annual meeting);
- Disclose information required pursuant to Schedule 14A in connection with the solicitation of proxies, including the same information that must be supplied by the company with respect to board-approved nominees for election to the board of directors;
- Disclose whether the shareholder or any member of the group has been involved in legal proceedings during the past 10 years; and
- Provide any statement of support with respect to a nominee that the shareholder or group would like to have included in the company’s proxy materials, not to exceed 500 words per nominee.

Liability for False Statements

Schedule 14N will be deemed soliciting materials for purposes of liability for proxy violations under Section 14(a). As such, the SEC also amended Rule 14a-9 to hold a nominating shareholder or group liable for misstatements (or omissions) made in Schedule 14N regarding the nomination, regardless of whether or not such statements are included in the company's proxy statement. In addition, a company will not be liable for information contained in its proxy statement that is provided to the company by the nominating shareholder or group pursuant to Rule 14a-11.

Number of Shareholder Nominees

The company is required to include in its proxy materials no more than one shareholder nominee or nominees representing 25% of the company's board of directors, whichever is greater. In addition, in the event that the company has an incumbent director who was elected as a shareholder nominee pursuant to Rule 14a-11, and such director's term expires after the date of the meeting at which directors will be elected (this may be the case for a company with a staggered board), the company can exclude shareholder nominees from its proxy materials to the extent that the election of such nominees would result in the total number of Rule 14a-11 nominees being greater than 25% of the company's board. Where there is a staggered board, the 25% calculation is based on the total number of board seats. In the event that the company receives shareholder nominees from multiple eligible shareholders or groups, the company must give priority to the nominating shareholder or group with the highest qualifying voting power percentage. If that shareholder does not nominate the maximum number of permitted nominees, then the nominees of the shareholder or group with the next highest qualifying voting power percentage will be included in the company's proxy materials as well. If the company agrees to accept as a company nominee a person nominated by an eligible shareholder, such nominee "counts" toward the 25% limit.

In addition, if the company's proxy includes a shareholder nominee, then each nominee for directorship must be voted separately and the company cannot provide shareholders with the ability to vote for a slate consisting solely of the company's nominees.

Formation of Shareholder Nominating Groups

Rule 14a-11 permits shareholders to form groups that aggregate their shares in order to meet the "Minimum Ownership Threshold." In order to facilitate communications between shareholders in their efforts to form nominating shareholder groups, the SEC has provided that such communications will not run afoul of the SEC's proxy solicitation rules, provided that such communications are limited in content and the soliciting shareholder is not seeking a change of control of the company or more than the maximum number of permitted nominees. To the extent that such communications are in writing, they must be filed with the SEC.

Such written communications must include no more than:

- A statement of the shareholder's intent to form a nominating shareholder group in order to nominate a director under the new rule;
- Identification of, and a brief statement regarding, the potential nominee or nominees, or, where no nominee or nominees have been identified, the characteristics of the nominee or nominees that the shareholder intends to nominate, if any;
- The percentage of securities that the shareholder beneficially owns or the aggregate percentage owned by any group to which the shareholder belongs; and
- The means by which shareholders may contact the soliciting party.

If a shareholder nominating group holds greater than 5% of the company's equity securities, then the formation of such group must be reported on Schedule 13D or 13G. Shareholders relying on Rule 14a-11 would not, however, become ineligible to file a Schedule 13G (in lieu of a Schedule 13D) solely due to their Rule 14a-11 activities.

Process for Challenging Shareholder Nominations

In the event that an unqualified shareholder or group of shareholders attempts to take advantage of Rule 14a-11, Schedule 14N is deficient or Rule 14a-11 does not apply to the company, the company must, no later than 106 days before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting, notify the nominating shareholder or group of any determination not to include the nominee(s). The nominating shareholder or group can respond to the company's deficiency notice within 14 days after its receipt thereof.

In addition, no later than 80 days before the company files its definitive proxy statement and form of proxy with the SEC, the company must provide to the SEC notice of the company's intent to exclude a nominating shareholder's or group's nominee(s) and the reasons for such exclusion. The company can also seek a no-action letter from the SEC staff with regard to such proposed exclusion. The nominating shareholder or group will have 14 days to respond to the company's deficiency notice filed with the SEC. Thereafter the SEC will, at its discretion and if requested by the company, provide to the company and the nominating shareholder or group an informal statement of its views regarding the proposed exclusion.

Revisions to the Election Exclusion

Rule 14a-8(i)(8) was amended to allow shareholders, under certain circumstances, to require companies to include in company proxy materials proposals that would amend, or that request an amendment of, the company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided such proposal does not conflict with Rule 14a-11. Effectively, Rule 14a-8(i)(8) therefore applies to amendments that, for example, seek to (a) reduce the 3% minimum ownership requirement or the three-year holding requirement, or (b) increase the 25% limit on Rule 14a-11 nominees. In addition, while the applicability of Rule 14a-11 to smaller reporting companies has been delayed for three years, such delay does not apply to Rule 14a-8(i)(8).

Recommendations

The new rules underscore the importance of (a) maintaining an open dialogue with shareholders, and (b) being adequately prepared to deal with any potential unwanted actions by dissident shareholders. Although Schedule 14N must be filed no later than 120 days before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting, advance notice provisions in the company's bylaws continue to be important as they relate to shareholders who otherwise are not qualified to take advantage of the new rule (e.g., shareholders attempting to effect a change of control of the company, or activist shareholders who do not qualify for proxy access under Rule 14a-11). As such, companies that do not currently have advance notice provisions in their bylaws should consider adopting such provisions. Furthermore, companies should prepare for the possibility that their bylaw provisions regarding nomination procedures or disclosures may come under attack in the form of a Rule 14a-8(i)(8) amendment shareholder proposal.

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