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SEC Proposes Significant Proxy Rule Changes to Provide Shareholder Access to the Director Nomination Process

June 22, 2009

On June 10, 2009, the U.S. Securities and Exchange Commission (the "SEC") issued [Release No. 33-9046](#) (the "Release") proposing significant changes to its proxy rules that would grant certain shareholders the ability to have their own director nominees included in a company's proxy materials. The Release embodies the proposals approved by the SEC in May 2009 as discussed in our [May 22, 2009 Alert](#).

The Release cites the current economic crisis and concerns about "whether boards are exercising appropriate oversight of management, whether boards are appropriately focused on shareholder interests, and whether boards need to be more accountable for their decisions regarding such issues as compensation structures and risk management" as catalysts for the SEC's decision to "revisit whether and how the federal proxy rules may be impeding the ability of shareholders to hold boards accountable through the exercise of their fundamental right to nominate and elect members to company boards of directors."

To facilitate shareholders' ability to meaningfully exercise their rights, the SEC is proposing a new Exchange Act Rule 14a-11 ("Rule 14a-11") and an amendment to Exchange Act Rule 14a-8 ("Rule 14a-8").

Rule 14a-11

If a shareholder or shareholder group satisfies the proposed eligibility standards and the other requirements of Rule 14a-11, the rule would require the company to include the shareholder's or shareholder group's nominee(s) in its proxy materials. As proposed, Rule 14a-11 generally would apply to any company subject to the SEC's proxy rules unless applicable state law or the company's governing documents prohibit shareholders from nominating candidates to the board of directors. Rule 14a-11 would not be available to shareholders seeking to rely on the rule to change the control of the company or to gain more than a permitted number of seats on the board of directors. The proposed eligibility standards are based on the following minimum ownership levels and duration of ownership.

Minimum Ownership Levels

In order to avail itself of Rule 14a-11, a shareholder or shareholder group must satisfy a minimum ownership level, based on the size of the company, as follows:

- One percent of the voting securities of a "large accelerated filer" (a company with a worldwide market value of \$700 million or more) or of a registered investment company with net assets of \$700 million or more;
- Three percent of the voting securities of an "accelerated filer" (a company with a worldwide market value of \$75 million or more but less than \$700 million), or of a registered investment company with net assets of \$75 million or more but less than \$700 million; or
- Five percent of the voting securities of a "non-accelerated filer" (a company with a worldwide market value of less than \$75 million) or of a registered investment company with net assets of less than \$75 million.

Groups of shareholders would be permitted to aggregate their holdings to meet these minimum ownership thresholds. A five percent or greater aggregate amount would implicate the reporting requirements under Exchange Act Section 13(d). However, as proposed, the formation of a shareholder group solely for the purpose of nominating one or more directors would not result in a nominating shareholder or shareholder group from losing its eligibility to file on Schedule 13G.

Duration of Ownership

The shareholder or shareholder group would be required to:

- Have held the securities relied upon to satisfy the minimum ownership threshold continuously for a period of at least one year as of the date the shareholder or shareholder group provides notice to the company;
- State in writing its intent to hold the securities through the date of the annual meeting at which the directors are to be elected; and
- Certify that it is not holding the securities for the purpose of changing control of the company or to gain more than a minority representation on the company's board of directors.

The first shareholder, or shareholder group, that satisfies these requirements would be permitted to nominate the greater of one nominee or that number of nominees representing up to 25 percent of the company's board of directors. The SEC recognized this first-in-time standard differs from the standard proposed in 2003 that would have allowed the largest shareholder or shareholder group to have its nominee included in the company's proxy materials. The SEC believes this first-in-time standard would provide companies more certainty and would be fairer to shareholders and shareholder groups that may want to have nominees included in the company's proxy material.

The Release includes a significant limitation relative to staggered boards that was not included in the proxy rules proposed earlier. If a shareholder nominee who was nominated by any shareholder or shareholder group is then serving on the company's board of directors and the term of that director would extend past the date of the shareholder meeting, that nominee will count toward the one shareholder nominee or the 25-percent cap, as applicable. As a consequence, the company would not have to include on its board at any time more than the total number of shareholder nominees required to be included under Rule 14a-11.

Shareholder Nominee Qualifications

Under Rule 14a-11, as proposed, shareholder nominees must satisfy objective director-independence standards of the applicable national securities exchange or national securities association; the nominee's candidacy and election must comply with applicable laws and regulations; and the nominating shareholder or shareholder group must represent that the nominee is in compliance with these standards. Each nominating shareholder must also represent that neither the nominee nor the nominating shareholder nor, where there is a nominating shareholder group, any member of the nominating shareholder group, has an agreement with the company regarding the nomination. Negotiations or other communications limited to whether the company should include the nominee on the company's proxy would not be considered an agreement for this purpose. However, any financial transaction or business relationship since the beginning of the company's last fiscal year, or any currently proposed transaction, between the company and a shareholder nominee that exceeds \$120,000 would be a required disclosure on the proposed new Schedule 14N. There would be no limitation on the relationships between a nominating shareholder or shareholder group and its director nominees.

Disclosure Requirements

Nominating Shareholders

In addition to the shareholder eligibility and nominee requirements, shareholders nominating a candidate would be required to send to the company and file with the SEC a new Schedule 14N to disclose, among other things:

- The amount and percentage of company securities owned by the nominating shareholder;
- The length of ownership of the company securities; and
- The nominating shareholder's or shareholders group's intent to continue to hold the securities through the date of the meeting and further intent with respect to continued ownership after the election.

In addition, a nominating shareholder or shareholder group must include a certification that the shareholder or shareholder group is not seeking to change the control of the company or to gain more than a permitted number of seats on the board of directors. The nominating shareholder or shareholder group would be liable for any false or misleading statements in these disclosures.

Proxy Disclosure

A company would be required to include disclosure relating to nominating shareholders and shareholder nominees similar to that required by the current disclosure requirements applicable to contested elections. However, a company would not be liable for any false or misleading information obtained from the nominating shareholder or shareholder group unless the company knew, or had reason to know, that the information was false or misleading.

Rule 14a-8

Paragraph (i)(8) of Rule 14a-8 currently allows a company to exclude a shareholder proposal from its proxy statement that "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election." The proposed amendment would allow a shareholder, if the shareholder satisfies the eligibility provisions of proposed Rule 14a-8 (which are materially different from the eligibility provisions of proposed Rule 14a-11), to submit proposals that would amend, or that request an amendment to, a company's governing documents (e.g., the bylaws) regarding nomination procedures or disclosures related to shareholder nominations. The proposed amendment to Rule 14a-8 would not restrict the types of amendments that a shareholder could propose; however, any proposals that would conflict with Rule 14a-11 or state law could be excluded. Having differing eligibility thresholds or requiring more disclosure than otherwise required under Rule 14a-11 would not be deemed to be conflicting; however, amending procedures that would prevent a shareholder or shareholder group from meeting the requirements of proposed Rule 14a-11 would be deemed conflicting.

The proposed amendment to Rule 14a-8 would also codify prior SEC interpretations. Therefore, a company would be permitted to exclude a proposal under Rule 14a-8 if it would:

- Disqualify a nominee who is standing for election;
- Remove a director from office before his or her term expires;
- Question the competence, business judgment or character of one or more nominees or directors;
- Nominate 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 an upcoming election of directors.

The SEC cautions that the proposed amendment to Rule 14a-8 should not be read so broadly that the provision could be used to permit exclusion of proposals regarding the qualifications of directors, shareholder voting procedures, board nomination procedures and other election matters of significance to shareholders that would not directly result in an election contest between management and shareholder nominees, and that do not present significant conflicts with the SEC's other proxy rules.

The eligibility provisions of Rule 14a-8 require a shareholder to continuously hold at least \$2,000 in market value (or one percent, whichever is less) of a company's securities entitled to be voted for a period of one year prior to submitting a proposal.

Observations

It is anticipated that the SEC will adopt some version of these proposed proxy access rules by the end of 2009, thereby allowing interested shareholders to utilize the rule changes to participate in the 2010 proxy season.

If adopted as proposed, Rule 14a-11 and the amendment to Rule 14a-8 would create a "significant change" in the corporate proxy process. The SEC is currently seeking public comments on more than 500 specific questions relating to the proposed rule changes. The final version of the proxy access rules may ultimately depend on the comments the SEC receives to the numerous questions raised in the Release, including:

- What the proper remedy should be if the nominating shareholder or shareholder group represents its intent to hold the securities through the date of the meeting but fails to do so, and what effect such failure should have on the election?
- What should happen if a nominating shareholder qualifies, provides notice and submits all of the nominees a company is required to include in its proxy and then becomes ineligible under Rule 14a-11?
- Should the first shareholder or shareholder group be able to nominate up to the total number of shareholder nominees required to be included by the company, or where there is more than one nominating shareholder or shareholder group and more than one slot for nominees, should the slots be allocated among the proposing shareholders in the order in which they provided notice to the company?
- What should be the consequence if a nominating shareholder or shareholder group includes materially false information or a materially false representation on Schedule 14N, whether before inclusion of a nominee in the company's proxy materials, after inclusion of a nominee in the company's proxy materials but before the election, or after a nominee has been included in the company's proxy materials and elected?
- Should a nominating shareholder or shareholder group be permitted to change its composition to correct an identified deficiency, such as a failure to satisfy the requisite ownership threshold, or be allowed to submit a replacement shareholder nominee in the event it is determined the nominee does not satisfy the eligibility criteria?

The significance of the proposed changes to the corporate proxy process indicates that the SEC should consider the responses it receives during the comment period before adopting the rule proposals, rather than rushing the process to make the new provisions applicable for the 2010 proxy season.

Comments must be received by the SEC no later than August 17, 2009. The SEC will post all comments online at www.sec.gov/rules/final.shtml. We will continue to monitor these and other proxy access developments.

For Further Information

If you have any questions regarding the corporate governance proposals presented above, including how they may affect your company, please contact [Laurence S. Lese](#), [Howell J. Reeves](#), [David J. Kaufman](#), [Heather N. King](#), any [member](#) of the [Securities Law Practice Group](#) or the lawyer in the firm with whom you are regularly in contact.