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SEC Adopts Proxy Access Rules

At an open meeting held on August 25, 2010, the U.S. Securities and Exchange Commission (the "SEC") adopted significant changes to the federal proxy rules, granting shareholders the right to propose director nominees in a company's proxy statement under certain circumstances. Proxy access is largely implemented through new Rule 14a-11 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Effective Date

Rule 14a-11 will be effective 60 days from publication in the Federal Register and will apply to the next annual meeting of shareholders of a covered issuer, unless the advance notice window for shareholder nominations described below closes before the effective date.

Covered Issuers

The proxy access requirements will apply to companies that are subject to the Exchange Act proxy rules, including investment companies registered under Section 8 of the Investment Company Act of 1940 (the "1940 Act"). It will also apply to controlled companies and those companies that choose to voluntarily register a class of securities under Section 12(g). Smaller reporting companies will not be subject to the new rule for three years in order to allow time for such companies to observe how the rule operates for larger companies and to better prepare for implementation. Finally, issuers that are subject to the proxy rules solely because they have a class of debt securities registered under Section 12 of the Exchange Act and foreign private issuers will not be subject to Rule 14a-11.

Shareholder Nominations

Rule 14a-11 requires a company to include one shareholder nominee, or a number of nominees that represents up to 25% of the company's entire board of directors, whichever is greater. Where there are multiple eligible nominating shareholders, the nominating shareholder or group with the highest percentage of the voting power of the company's outstanding securities entitled to be voted at the meeting will have its nominees included in the company's proxy materials. In order to use Rule 14a-11, a nominating shareholder or group of nominating shareholders must satisfy the following requirements:

- The nominating shareholder or group must own at least three percent of the voting power of the company's securities entitled to be voted at the meeting. The nominating shareholder or group must hold both investment and voting power of the securities, either directly or through any person acting on their behalf. In calculating the percentage of ownership held, securities loaned to a third party may be included but securities sold short or borrowed must be deducted and may not be counted toward the required ownership threshold.
- The nominating shareholder or group must have held the qualifying amount of securities continuously for at least three years at the time it submits a notice of its intent to use Rule 14a-11 on Schedule 14N. The nominating shareholder or group must also continue to own the qualifying amount of securities through the date of the meeting at which directors are elected and must provide disclosure on Schedule 14N concerning its intent with regard to continued ownership of the securities after the election of directors.
- The nominating shareholder (or where there is a group, each member of such group) may not hold the company's securities with the intention of seeking to change control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11. Such shareholders may not have any type of agreement, direct or indirect, with the company regarding the nomination prior to filing the Schedule 14N.
- The board membership of the shareholder nominee, if elected, must not violate applicable state, foreign or federal law, or the applicable standards of a national securities exchange or association, except for independence requirements that rely on a subjective determination by the board. The nominee need not satisfy any director qualifications set forth in the company's charter or bylaws in order to be included in the proxy statement (though the nominee must be so qualified in order to take office, if elected, and the SEC acknowledges this in the adopting release).
- The nominating shareholder or group must notify the company of its intent to use Rule 14a-

11 by filing Schedule 14N on EDGAR and transmitting such notice to the company no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement and no later than 120 days prior to such date.

- Schedule 14N requires the information necessary to verify compliance with the above requirements and permits, at the option of the nominating shareholder or group, a statement in support of each nominee, not to exceed 500 words per nominee.

A company that receives a notice on Schedule 14N from an eligible nominating shareholder or group will be required to include disclosure concerning the nominating shareholder or group and the shareholder nominees in its proxy statement and must include the names of the shareholder nominees on its proxy card.

Response to a Shareholder Nomination

If a company receives a nomination submitted pursuant to Rule 14a-11 and determines that it will include the nominating materials in its proxy statement, the company will be required to notify the nominating shareholder or group by sending the shareholder notification, postmarked no later than 30 calendar days before the company files its definitive proxy materials.

If the company wishes to exclude the nominee, there are some instances when a company may be permitted to do so. For instance, a company is not required to include a nominee if:

- the nominee or the nominating shareholder, or shareholder group, fails to satisfy the eligibility requirements for Rule 14a-11; or
- the nominee would cause the company to exceed the maximum number of nominees that it is required to include in the proxy statement and form of proxy.

Additionally, a company may exclude a statement in support of a nominee that exceeds 500 words. A company may not exclude a shareholder's proposal because it is false or misleading; rather, the nominating shareholder would be liable for any misrepresentations in its nomination. To exclude a shareholder nomination, a company must follow the SEC's notice and review requirements.

The process for excluding a nominee generally will operate as follows:

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 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
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, where applicable, cure any defects in the nomination
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC	Company must provide notice of its intent to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination to the SEC 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 staff
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
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

Other Noteworthy Aspects of Proxy Access

- There is no exception to Rule 14a-11 for companies that are subject to, or anticipate being

subject to, a concurrent proxy contest for the election of directors. However, a nominating shareholder or group cannot use 14a-11 to nominate a director and then engage in a non-Rule 14a-11 solicitation for directors or participate in another person's solicitation with regard to the election of directors.

- Unlike unsuccessful Rule 14a-8 proposals, there is no limitation on resubmission of an unsuccessful nominee under Rule 14a-11 at succeeding annual meetings.
- Company proxy cards may not provide a means to vote for the board's nominees as a group if a Rule 14a-11 nominee is included on the card.

Rule 14a-11 will apply even if state or foreign law or a company's governing documents prohibit the inclusion of shareholder director nominees in the company's proxy materials or set share ownership or other conditions that are more restrictive than Rule 14a-11. If state law or a company's governing documents are less restrictive than Rule 14a-11, a shareholder may follow the procedures set forth under state law or the company's governing documents, subject only to certain required disclosure on a new Schedule 14N. If some aspects of state law or the governing documents are more restrictive, but others are less restrictive than Rule 14a-11, the shareholder can either utilize Rule 14a-11 or follow the procedures set forth under state law and/or the company's governing documents, but may not pick and choose between the two options.

Shareholder Proposals to Modify Company Procedures for Electing Directors

In addition to adopting new Rule 14a-11, the SEC amended Rule 14a-8(i)(8) to narrow the scope of the exclusion in Rule 14a-8(i)(8) relating to election of directors. Prior to enactment of the amendments, Rule 14a-8(i)(8) permitted the exclusion of a shareholder proposal 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 SEC's new rule amends this exclusion to allow shareholders to submit proposals that modify or amend a company's procedures for nominating or electing directors, presumably by amendment of the bylaws, including procedures for including one or more shareholder nominees for director in the company's proxy materials. However, the new rule permits companies to exclude a shareholder proposal pursuant to Rule 14a-8(i)(8) if it:

- Would disqualify a nominee who is standing for election;
- Would remove a director from office before his or her terms expires;
- 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.

Thus, shareholders could propose modifying the company's election procedures to make it easier for shareholders to place nominees on a ballot. These proposals could seek to include a number of provisions relating to director nominations different than those contained in Rule 14a-11, including a different ownership threshold, holding period, or other qualifications. To the extent that shareholders are successful in adopting amendments to a company's governing documents to establish new procedures, the provisions would be an additional avenue for shareholders to submit nominees for inclusion in company proxy materials, not a substitute for, or restriction on, Rule 14a-11.

If a nominating shareholder is relying on a procedure under state or foreign law or a company's governing documents to include a nominee in a company's proxy materials, the nominating shareholder would be required to provide disclosure concerning the nominating shareholder and the nominee to the company on Schedule 14N and must file Schedule 14N on EDGAR. These disclosure requirements on Schedule 14N largely mirror those required for a Rule 14a-11 nomination.

Related Amendments to Exchange Act Rules and Forms

- New Rule 14a-2(b)(7) provides an exemption from the disclosure, filing and other requirements of the proxy rules for solicitations in connection with the formation of a nominating shareholder group, provided that certain conditions are met and that any written soliciting material is restricted to four limited categories of information and filed on a Schedule 14N. There is no content limitation in connection with oral communications, but the soliciting shareholder must file a Schedule 14N notice of the commencement of the oral solicitation.
- New Rule 14a-2(b)(8) provides an exemption from the disclosure, filing and other requirements of the proxy rules for solicitations by or on behalf of a nominating shareholder or group, provided that the soliciting party does not solicit proxies and that certain other

conditions are met, including that any soliciting material published, sent or given to shareholders under this exemption be filed on a Schedule 14N, with copies provided to the applicable national securities exchange. This exemption and the exemption under Rule 14a-2(b)(7) do not apply to non-Rule 14a-11 solicitations pursuant to a procedure set forth in the company's governing documents.

- The SEC amended the beneficial ownership reporting rules so that shareholders or groups relying on Rule 14a-11 would not become ineligible to file a Schedule 13G, in lieu of filing a Schedule 13D, solely as a result of activities in connection with the inclusion of a nominee under Rule 14a-11. The SEC noted that election as a director pursuant to a Rule 14a-11 nomination may result in ineligibility to continue under a Schedule 13G filing.
- Form 8-K now includes a new Item 5.08, which requires reporting of the deadline for a shareholder notice on Schedule 14N where (a) the company did not hold an annual meeting in the previous year or the meeting date has been changed by more than 30 days from the anniversary of the previous year's meeting or (b) the company is required to include shareholder director nominees in its proxy materials under state or foreign law or its governing documents. Additionally, investment companies that are series companies under the 1940 Act must report certain information regarding outstanding voting securities in connection with a pending election of directors. The foregoing information must be reported on a Form 8-K within four business days after the company determines the anticipated shareholder meeting date.

While the three-year holding period and three percent ownership requirements may limit the use of proxy access, the changes adopted by the SEC will add a new dimension and level of uncertainty to the annual meeting process. Please call us or our colleagues if you have any questions relating to the conduct of an annual meeting of shareholders in light of proxy access and the related rule changes.

Please contact any member of our [Corporate Finance and Securities Group](#) if you have questions regarding this alert.

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