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## SEC Adopts New Rules Facilitating Director Nominations by Shareholders

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**On August 25, 2010, the SEC adopted changes to the federal proxy rules to better enable shareholders to nominate directors to the boards of public companies. New rule 14a-11 of the Securities Exchange Act of 1934 (Exchange Act) will require companies to include the shareholder nominations in their proxy statements alongside company nominations, subject to certain state and foreign law prohibitions and certain eligibility criteria of both the nominating shareholder and the director nominee.**

By way of background, the directors of a public company are typically nominated by a company's board for annual election by the company's shareholders. A company's proxy statement identifies and provides biographical information regarding the nominees for director. Thus, a board normally nominates the directors to stand for election at the annual meeting of shareholders.

Currently, a shareholder is able to nominate his or her own nominees in one of two ways: (1) by a "proxy contest," which would require the nominating shareholder to file and mail a separate proxy statement by complying with the company's advance notice bylaw requirements, or (2) in many situations, at the annual meeting of shareholders. Unfortunately for shareholders, the first option can be prohibitively expensive and the second option is a meaningless alternative in today's environment as most proxy votes are cast prior to the annual meeting. These options remain available, however, for stockholders who are unable to meet the criteria provided in the new rules.

### Including Director Nominees in the Company's Proxy Materials

#### *Adoption of Exchange Act Rule 14a-11*

Under new Rule 14a-11, companies will be required to include shareholder nominees for director in the company's proxy materials if the nominating shareholder meets certain criteria and if the shareholder is not otherwise prohibited from nominating a candidate for election as a director. Rule 14a-11 will become effective 60 days from the date the rules are published in the Federal Register.

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Under Rule 14a-11, shareholders must submit nominees no later than 120 days before the anniversary date of the mailing of the company's proxy statement in the prior year. Shareholders will be able to submit nominees for inclusion in the next year's proxy statement if the 120-day deadline falls on or after the effective date of the rules.

#### *Subject Companies*

All Exchange Act reporting companies are subject to the new rule, except for companies whose only public securities are debt securities. "Smaller reporting companies" (which are generally defined as a company with a public float held by non affiliates of less than \$75 million) are also subject, but a three-year phase-in period will be applied to them. Foreign companies are only subject if they do not qualify as a "foreign private issuer."

#### *Nominating Shareholder Criteria*

In order for shareholders to nominate directors for election at the meeting of shareholders, the shareholders must satisfy the following conditions:

The nominating shareholder must hold investment and voting power, either directly or through any person acting on its behalf, of at least three percent of the total voting power of the company's securities that are entitled to be voted on the election of directors. A shareholder group will be able to aggregate their shares to meet the threshold. In calculating the threshold percentage, a shareholder can rely on the most recent 10-K, 10-Q or 8-K filed by the company containing the total voting power of the company's securities unless the nominating shareholder has reason to believe that the information provided in those statements is incorrect.

The nominating shareholder must have held his or her shares for at least three years and must continue to own the requisite shares through the date of the meeting at which directors are elected. For a shareholder group, each individual shareholder must have held the securities that are being counted towards meeting the threshold for three years.

The nominating shareholder cannot have a direct or indirect agreement with the company regarding the nomination prior to making the filing on Schedule 14N, as described below.

Shareholders who are holding securities for the purpose of changing control of the company or to gain a number of seats on the board of directors exceeding the number of nominees that a company is required to include under the new rules will not be eligible to use the rule.

The nominating shareholder is ultimately responsible for the information he or she provides to the company which is then reproduced in the company's proxy materials. Further, such nominating shareholder will

comprehensive compliance programs.

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be liable for any false or misleading statements it makes about the nomination, whether or not the statements are included in the company's proxy materials.

#### *Director Nominee Criteria*

The director nominee must meet the following criteria:

The director nominee must satisfy the objective independence standards of the applicable national securities exchange or national securities association; and

There must be no direct or indirect agreement with the company regarding the nomination of the nominee.

In addition, the nominee's candidacy cannot violate applicable laws and regulations. There will, however, be no restrictions on the relationship between the nominating shareholder and the director nominee.

#### *Limitation on the Number of Nominees*

The nominating shareholder is limited to nominating one nominee or a number of nominees who represent up to 25 percent of the company's board of directors, whichever is greater.

#### *Director Nominee Disclosure Requirements*

The nominating shareholder will be required to file with the Securities and Exchange Commission (SEC) and provide to the reporting company a Schedule 14N which will be publicly available on the SEC's website. Schedule 14N will require that the nominating shareholder confirm that he or she meets the conditions to be able to nominate the director(s). The schedule will also identify the nominee(s) and will include biographical information about such nominee(s), including a description of the nature and extent of the relationship between the nominating shareholder and the nominee(s) and the company.

The company's proxy materials will include disclosure regarding the director nominee(s) as well as the nominating shareholder that is similar to the disclosure required in a contested election.

#### **Allowing Shareholders' Proposals**

The SEC also amended Exchange Act Rule 14a-8(i)(8), which will require companies to include proposals by certain shareholders that seek to establish a procedure in the company's governing documents for the inclusion of shareholder director nominees in the company's proxy materials. Currently, the rule permits companies to exclude shareholder proposals that relate to elections. The proposals must be made by shareholders who meet the eligibility provisions of Rule 14a-8; that is, the shareholder must have continuously held at least \$2,000 in market value (or 1 percent, whichever is less) of the company's securities entitled to be voted on the proposal at the meeting for a period of one year prior to submitting the proposal.

For Rule 14a-8, to have a proposal included in a company's proxy materials, a shareholder must submit the proposal no later than 120 days before the anniversary date of the mailing of the company's proxy statement in the prior year. Shareholders will be able to submit proposals for inclusion in the next year's proxy statement if the 120-day deadline falls on or after the effective date of the rules.

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