

SEC Adopts Proxy Access Rules

New Rules Applicable for 2011 Proxy Season for Most Companies

August 30, 2010

On August 25, 2010, the SEC adopted Rule 14a-11, the shareholder proxy access rule that was originally proposed on June 10, 2009. The SEC approved a revised version of the rule by a 3-2 vote along party lines. The recent passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act clarified the SEC's authority to order proxy access and thus removed a major legal concern about enforcement of the rule. The following is a brief summary of the new proxy access rules.

What is "Proxy Access?"

Rule 14a-11 provides large shareholders of public companies with a right to nominate directors and have the nominees included in the company's proxy statement and on the company's ballot, thus granting them "proxy access." Although shareholders have generally been able to nominate director candidates prior to the adoption of Rule 14a-11, they have not been entitled to have their nominees included in the company's proxy materials. Instead, shareholders have been required to go through the expense of filing separate proxy statements with the SEC and conducting their own shareholder mailings.

Which companies are subject to Rule 14a-11?

All public companies and registered investment companies that are subject to the proxy rules will be subject to Rule 14a-11, although application of the rule to smaller reporting companies is being delayed by three years. The rule will not apply to foreign private issuers¹ or to companies that are subject to reporting requirements solely because they have registered debt.

Do all shareholders have the right to proxy access?

No. In order to nominate directors and have them included in the company's proxy materials, a shareholder (or a group of shareholders who aggregates their holdings) must have continuously owned at least 3%² of the total voting power of a company's securities

¹ "Foreign private issuers" are not subject to the SEC's proxy rules and, therefore, are not subject to Rule 14a-11.

² When calculating the 3%, shareholders will be able to pool assets and include securities loaned to a third party as long as they can be called back. However, securities sold, shorted or not held through the company's annual meeting will need to be deducted.

for three years as of the date that the shareholder or group notifies the company of their proposed nomination³ and must state in writing an intention to continue to hold those shares through the date of the company's annual meeting.

How do eligible shareholders exercise their proxy access rights?

A nominating shareholder (or group) must submit a notice to the company no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date on which the company mailed its proxy materials for the previous year's annual meeting.⁴ A nominating shareholder must also file this notice with the SEC.

The notice, which will be in the form of a new Schedule 14N, must disclose a variety of matters, including:

- the amount and percentage of securities owned by the nominating shareholder;
- the length of time of the nominating shareholder's ownership;
- information about the nominating shareholder and nominees that is the same as would be required in a proxy contest;
- the nominating shareholder's intent to continue to hold the securities through the date of the meeting, and
- whether the nominee satisfies the director qualification requirements, if any, as set forth in the company's governing documents.

Schedule 14N also requires that the nominating shareholder or group certify that it is not seeking to change control of the company or to gain more than minority representation on the board of directors. A nominating shareholder or group may also submit a statement of support for the nominee that is no longer than 500 words to be included in the proxy statement.

The nominating shareholder or group will be liable for any false or misleading statements included on Schedule 14N or which the shareholder causes to be included in the company's proxy materials. A company will not be responsible for information provided

³ The ownership test is based on percentage of "voting power" of the company's securities entitled to be voted at the meeting, rather than as a percentage of outstanding securities. Accordingly, where a company has multiple classes of stock with unequal voting rights and the classes vote together on the election of directors, voting power would be calculated based on the collective voting power of all such classes.

⁴ If the date of a company's annual meeting has changed by more than 30 days from the prior year, or the company did not hold an annual meeting during the prior year (or if a company is holding a special meeting or conducting an election of directors by written consent), then the notice is required to be submitted to the company and filed with the SEC a reasonable amount of time before the company mails its proxy materials. In this scenario, the company is required to file a Current Report on Form 8-K under new Item 5.08 disclosing the date on which notifications must be received. The Form 8-K must be filed within four business days after the current year's meeting date has been determined.

by the nominating shareholder or group and then reproduced in the company's proxy materials.

How many nominees can be placed on the ballot by shareholders?

A shareholder or group may nominate and include in the company's proxy materials the greater of one nominee or up to 25% of the number of total board seats.⁵ If more nominees are submitted than would be permissible under the rule, the company will be required to include in its proxy materials only the nominees put forward by the largest shareholder(s) or group(s) who have made valid nominations.

Who can be nominated as a shareholder candidate? Are there other limitations on the right to proxy access?

For a nominee to be eligible for inclusion in a company's proxy statement under Rule 14a-11, the nominee must satisfy the objective independence standards of the national securities exchange on which the company's securities are listed. Further, neither the nominating shareholder nor the nominee may have any direct or indirect agreement with the company regarding the shareholder's nomination and the nominating shareholder (or group) must not have the intent of changing control of the company. The SEC's no-action letter process can be used by companies to exclude shareholder nominees if they believe a shareholder nominee or a nominating shareholder (or group) does not satisfy the new rule's eligibility requirements.

Can companies "opt out" of proxy access?

No. Proxy access is mandatory and neither companies nor shareholders are permitted to opt out or limit the availability of the new proxy access rules. A company's shareholders may, however, choose to adopt access rules that provide for greater access either through a management recommendation or a shareholder proposal under Rule 14a-8.

How does proxy access apply to a company if its governing law or charter documents prohibit shareholders from nominating directors or if they provide for nominating procedures that are inconsistent with Rule 14a-11?

Rule 14a-11 will not apply to a company if its governing law or charter documents prohibit shareholders from nominating directors altogether. If shareholder nominees are

⁵ For companies with staggered boards, shareholders will be entitled to nominate and include 25% of the number of total board seats (not 25% of the lesser number of board seats that are up for election at a particular meeting). Once elected, however, a shareholder-nominated director whose term extends beyond the date of the subsequent year's meeting would count for purposes of the 25% maximum at such subsequent year's meeting.

prohibited by a company's charter documents but permitted by governing law,⁶ new amendments to Rule 14a-8 will permit shareholders to submit a proposal for inclusion in the company's proxy statement that seeks to remove such prohibition through amendment of the charter documents.⁷

Where governing law and a company's charter documents permit shareholder nominations but prohibit inclusion of shareholder nominees in the company's proxy materials, or establish share ownership or other requirements that are inconsistent with Rule 14a-11, shareholders will be permitted to submit director nominees under Rule 14a-11 as long as they satisfy the requirements of the rule (without regard to prohibitions in, or inconsistencies with, governing law or charter documents). For example, if a company's bylaws require that shareholder nominees be included in company proxy materials only if submitted by a 10% shareholder, a shareholder who does not meet the 10% threshold but does meet all requirements of Rule 14a-11 (including the 3% ownership threshold described above) would be able to submit its nominee(s) for inclusion in the company's proxy materials pursuant to Rule 14a-11.

Where governing law or charter documents are more permissive than Rule 14a-11 in certain respects and more restrictive in other respects, a shareholder may rely on either Rule 14a-11 or on governing law and the company's charter documents.⁸ In this instance, however, a shareholder must clearly evidence its intent to rely on one or the other, and then meet all of the requirements of whichever procedure it selects. Shareholders may not "pick and choose" among the different aspects of different procedures.

When do the proxy access rules take effect?

Rule 14a-11 will be effective for the 2011 proxy season for most calendar year-end companies, other than smaller reporting companies. Specifically, the rule will take effect 60 days after the publication of the adopting release in the Federal Register, which is

⁶ The SEC's adopting release notes that the SEC is not aware of any state laws that prohibit shareholders from nominating directors.

⁷ Prior to the effect of the Rule 14a-8 amendments, Rule 14a-8 permits companies to exclude a shareholder proposal from company proxy statements if the proposal relates to a director nomination or election or procedure for such nomination. As amended, the rule will permit the exclusion of a shareholder proposal related to director elections only if the proposal (i) would disqualify a nominee who is standing for election; (ii) would remove a director from office before the expiration of his or her term; (iii) questions the competence, business judgment, or character of one or more nominees or directors; (iv) seeks to include a specific individual in the company's proxy materials for election to the board of directors; or (v) otherwise could affect the outcome of the upcoming election of directors.

⁸ For example, if a company's bylaws require 10% ownership to have nominees included in the company's proxy materials, but permit 10% shareholders to have nominees up to the full number of board seats included in a company's proxy materials, Rule 14a-11 would continue to be available for shareholders that are eligible to use it. However, the shareholder could instead choose to proceed under the procedures and standards of the company's bylaws.

expected to occur as early as this week. However, the deadline for submitting a nominee is 120 days before the anniversary of the current year's proxy mailing. As a result, access applies for an annual meeting next year only if the first anniversary of the mailing of proxy materials for the current year occurs 120 days or more after effectiveness. For example, if the adopting release is published in the Federal Register on September 2, 2010, Rule 14a-11 would become effective on November 1, 2010. Under this scenario, and in light of the 120-day advance notice requirement, the proxy access rules would apply only to companies that mailed their proxy materials for the previous year's annual meeting on or after March 1, 2010.

Are smaller reporting companies subject to Rule 14a-11?

Yes. However, implementation of the proxy access rules as they apply to smaller reporting companies (generally under \$75 million in public float) will be deferred for three years. Companies that currently qualify as smaller reporting companies will be required to comply with Rule 14a-11 immediately upon ceasing to be a smaller reporting company.

Where can I obtain a copy of the SEC's adopting release?

The adopting release, which includes the full text of the final rule, can be found at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

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