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## SEC Proposes 'Proxy Access' Rules

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### Introduction

The Securities and Exchange Commission has released its proposed “proxy access” rules. If adopted, the proposed rules would allow stockholders meeting specified eligibility criteria to require a public company to include the stockholders’ nominees for election to the company’s board of directors in the company’s proxy statement and proxy card. In addition, the proposal would amend the rule governing stockholder proposals, to permit a broader range of election-related proposals, and would revise related rules. Comments on the proposal are due August 17, 2009.

The SEC voted 3 to 2 to propose these new rules and amendments.<sup>1</sup> This is the third time in less than ten years that the SEC has considered proxy access.

### Proposed Rule 14a-11

The centerpiece of the proposal is a new Rule 14a-11, which would give stockholders access to a company’s proxy statement and proxy card. Rule 14a-11 would apply to all companies that are subject to the proxy rules, including companies registered under Section 8 of the Investment Company Act of 1940, other than companies that are subject to the Securities Exchange Act of 1934 solely because they have a class of debt securities that are registered under Section 12 of the Exchange Act.<sup>2</sup> As proposed, a public company would be subject to Rule 14a-11 unless state law or a company’s governing documents prohibit the stockholders from nominating candidates. Currently no state laws prohibit stockholder nominations. If a company’s governing documents did contain such a prohibition, stockholders could, under the proposed rules, seek to amend the provision by submitting a stockholder proposal under revised Rule 14a-8, as discussed below.

### Stockholder Eligibility: Ownership Requirements

A stockholder or group of stockholders would be eligible for access to the company’s proxy materials if the stockholder or group beneficially owned, as of the date of the stockholder notice on new Schedule 14N, individually or in aggregate:

- For large accelerated filers, 1% of the company’s securities that are entitled to vote on the election of directors;

- For accelerated filers, 3% of the company's securities that are entitled to vote on the election of directors; and
- For non-accelerated filers, 5% of the company's securities that are entitled to vote on the election of directors.

Stockholders in registered investment companies would also be subject to tiered eligibility requirements based on the net asset value of the investment company as of June 30 of the calendar year immediately preceding the calendar year of the meeting. A stockholder or group of stockholders in a registered investment company would be eligible for access to the company's proxy materials if the stockholder or group beneficially owned, as of the date of the notice on Schedule 14N, individually or in the aggregate:

- For registered investment companies with net assets of \$700 million or more, 1% of the company's securities that are entitled to vote on the election of directors;
- For registered investment companies with net assets of \$75 million or more but less than \$700 million, 3% of the company's securities that are entitled to vote on the election of directors; and
- For registered investment companies with net assets less than \$75 million, 5% of the company's securities that are entitled to vote on the election of directors.

In addition, the stockholder or each member of the group of stockholders must have continuously owned, for at least one year as of the date of the Schedule 14N, the securities that satisfy the ownership requirement, and must intend to hold those securities through the date of the stockholder meeting at which directors are to be elected.

#### Stockholder Eligibility: Disclosure and Other Requirements

To be eligible for access to a company's proxy materials, the stockholder or group of stockholders would also be required to comply with disclosure and other requirements. The principal disclosures must be set forth in a notice to the company on proposed Schedule 14N. Among other things, the stockholder or group would be required to disclose:

- The name and address of each nominating stockholder or each member of the stockholder group;
- Information about the number of securities owned by the stockholder or stockholders in the group;
- If the stockholder or group members are not record holders, a statement from the record owner verifying that the stockholder or stockholders have continuously owned their shares for at least one year;

- A statement of the stockholder or group's intent to hold the requisite shares through the date of the relevant meeting of stockholders;
- A statement of the stockholder or group's intent with respect to continued ownership after the election;
- A certification that, to the stockholder or group's knowledge and belief, the securities are not held for the purpose of, or with the effect of, changing control of the company or gaining more than a limited number of seats on its board;
- Information about the nature and extent of the relationships between the stockholder or group and the company and its affiliates; and
- Information about the director nominee or nominees.

If a company's advance notice bylaw specifies a deadline for notifying the company that a stockholder intends to nominate a candidate for election to the board, the stockholder or group would be required to file the Schedule 14N by that date. Otherwise, the Schedule 14N would be due 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.<sup>3</sup> Schedule 14N would be subject to the liability provisions of Rule 14a-9, the Exchange Act rule prohibiting material misstatements and omissions.

#### Nominee Requirements

A nominating stockholder or group would be required to make certain representations regarding each of their nominees in the Schedule 14N. Specifically:

- If the company, other than an investment company, is subject to the rules of a national securities exchange, the nominating stockholder or group must represent that the nominee complies with the "objective" portion of the exchange's independence standard.<sup>4</sup>
- For investment companies, the nominating stockholder or group must represent that the nominee is not an "interested person" as defined in Section 2(a)(19) of the Investment Company Act.
- The nominating stockholder or group must represent that neither the nominee nor the nominating stockholder or group has an agreement with the company regarding the nomination.

#### Maximum Number of Nominees for Inclusion

The SEC has stated that it does "not intend the proposed Rule 14a-11 to be available for any shareholder or group that is seeking to change the control of the issuer or to gain more than a limited number of seats on the board." To that end, the Commission has established a maximum number of stockholder nominees that would be required to be included in a company's proxy

materials. As proposed, a company would be required to include no more than one stockholder nominee, or the number of nominees that represents 25% of the company's board of directors, whichever is greater. If a current director was elected as a Rule 14a-11 nominee in a past election and that director's term would extend past the election for which the company is soliciting proxies, the company would not be required to include in its proxy materials more stockholder nominees than could result in the total number of Rule 14a-11 directors being greater than one or 25% of the board, whichever is greater. Fractions would be rounded down, so that a company with a seven-member board would be required to include no more than one Rule 14a 11 nominee in its proxy materials.

If more than one stockholder or group would be eligible to employ Rule 14a-11 to include a nominee in a company's proxy materials, the company would only be required to include the nominee of the first stockholder or group from which the company received a timely Schedule 14N. If the first stockholder or group nominated less than the maximum allowable number of directors, then the next eligible stockholder or group from which the company received a timely Schedule 14N would be allowed to nominate a number of directors, up to the maximum permitted by Rule 14a-11.

#### Requirements of a Company that Receives a Stockholder Nominee

Upon receipt of a Schedule 14N, a company would determine whether any of the events described below permitting exclusion of the nominee has occurred. If not, the company would be required to notify the nominating stockholder or group in writing, no later than 30 calendar days before the date the company files its definitive proxy materials with the Commission, that it will include the nominee in its proxy materials. If the company includes the nominee, the company would be required to include:

- In the company's proxy statement, a statement of up to 500 words by the nominating stockholder or group in support of the nominee; and
- The nominee's name on the company's proxy card.

The company would be permitted to identify the stockholder nominee as such and recommend that stockholders vote against the nominee, but the company's proxy card must present a stockholder nominee in what the SEC calls "an impartial manner."

A company could exclude a nominee if it determines any of the following:

- Proposed Rule 14a-11 is not applicable to the company;
- The nominating stockholder or group has not complied with Rule 14a-11;
- The nominee does not meet the requirements of Rule 14a-11;
- Any representation required of the nominating stockholder or group is false or misleading;  
or

- The company has received more nominees than it is required to include and the nominating stockholder or group does not meet the timeliness requirement.

If a company determines that the nominee is not eligible for inclusion, it must notify the nominating stockholder or group within 14 calendar days after it receives the stockholder or group's Schedule 14N, specifying the basis for the company's determination. The nominating stockholder or group would have 14 calendar days after receipt of the company's notice to correct any eligibility or procedural deficiencies and to respond to the company. The nominating stockholder or group could not change the composition of the group or substitute a different nominee, but if the stockholder or group proposed to nominate more than the number of directors permitted by Rule 14a-11, the stockholder or group could specify which nominee or nominees were to be included in the company's proxy materials. If the company determines that the stockholder's or group's response did not remedy the deficiency, the company would be required to notify the SEC, explaining the basis for its determination, no later than 80 calendar days before filing its definitive proxy materials. The company would provide a copy of this notice to the stockholder or group. Unless otherwise provided in Rule 14a-11, the burden would be on the company to demonstrate that it may exclude a nominee. The stockholder or group could respond to the company's notice by submitting a letter to the SEC, with a copy to the company, within 14 calendar days after receiving the company's notice. The SEC staff would then, at its discretion, provide an informal statement of its views, in the form of a no-action letter to the company and the stockholder or group. A company or a stockholder or group could request that the staff seek the Commission's views. The staff, upon request or on its own motion, would generally present only those questions that involve matters of substantial importance and where the issues are novel or highly complex. Under Rule 14a-11, the company would be required to notify the stockholder or group, at least 30 calendar days before filing its definitive proxy materials, whether it will include or exclude a proposed nominee.

#### **Proposed Amendment to Rule 14a-8(i)(8)**

Currently, Rule 14a-8(i)(8) permits a company to exclude from its proxy statement a stockholder proposal that relates to an election for membership on a company's board of directors or to a procedure for such nomination or election. Rule 14a-8(i)(8) is referred to as the "election exclusion." The SEC has proposed to narrow the election exclusion so that a company could not use Rule 14a-8(i)(8) as the basis for excluding a stockholder proposal that does not conflict with Rule 14a-11. (A company could, however, exclude a stockholder proposal that was consistent with Rule 14a-11 if there was another basis for excluding the proposal.) Thus, if a company's bylaws prohibited stockholders from nominating candidates for election to its board, a stockholder could submit a proposal amending or requesting that the board amend the bylaws to permit stockholder nominations.

#### **Other Proposed Rule Changes**

The proposal would revise the proxy rules so that stockholders could communicate with each other in an effort to form a group satisfying the relevant ownership requirement of Rule 14a-11 without complying with the filing and certain other requirements of the proxy rules.<sup>5</sup> In addition, and more significantly, the proposal would revise the proxy rules to permit a nominating stockholder or group

to solicit votes in favor of the stockholder or group's nominee or nominees, so long as:

- The soliciting party does not, at any time during the solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as a proxy;
- The soliciting party does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent, or authorization;
- Each written communication by the soliciting party includes specified information, including the identity of the soliciting party and a legend advising stockholders that a Rule 14a-11 nominee is or will be included in the company's proxy statement; and
- Any soliciting material published, sent, or given to stockholders by the soliciting party pursuant to the exemption is filed with the SEC no later than the date the material is first used.<sup>6</sup>

In addition, the SEC proposes to revise the rules governing Schedule 13G—a form available to certain investors who own 5% or more of a class of securities subject to the Exchange Act—to make clear that an institution would not lose its ability to file on Schedule 13G (rather than Schedule 13D) simply because the institution had nominated one or more directors pursuant to Rule 14a-11 or joined a group solely for the purpose of nominating one or more directors pursuant to Rule 14a-11.

Rule 14a-9 would also be amended so that a nominee, or a nominating stockholder or group, would be liable for the submission of any statement, “which at the time and in light of the circumstances under which it was made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in an earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.” A company would not be liable for any information provided by the nominating stockholder or group except where the company knew or had reason to know the information is false. In addition, any information provided to the company in a notice from a nominating stockholder or group and included in the company's proxy materials would not be incorporated by reference into any filings under the Securities Act, the Exchange Act, or the Investment Company Act unless the company specifically incorporated that information in its filing.

### **Arguments For and Against the Proposal**

Supporters of the current proposal, including SEC Chairman Mary Schapiro, assert that the recent economic crisis has raised concerns about the responsiveness of some companies and boards to the interests of stockholders. According to Chairman Schapiro, “[t]hese concerns have included questions 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.” Chairman Schapiro stated that the proposed proxy access rules provide the most cost effective means by which stockholders can “hold boards accountable.” In anticipation of

criticisms that the SEC lacks the authority to propose these rules and that the proposal inappropriately infringes on state law, supporters of the proposed rules note that the rules are explicitly intended to give stockholders access to a company's proxy materials only where state law and the company's governing documents permit them to nominate candidates for election to the board. Supporters also point out that the SEC has had the power to regulate the solicitation of proxies since 1934.

Opponents of the proposal raise a variety of objections, including the following:

- The proposal takes a "one size fits all" approach that does not adequately reflect the variety of companies' circumstances;
- The proposal inappropriately infringes on internal corporate affairs, the traditional domain of state law, and goes too far to establishing a federal corporate law; and
- The SEC lacks the authority to adopt these proposals.

Opponents also question whether the current economic crisis justifies the adoption of the proposed proxy access rules.

#### **What Companies Can Do Now**

Although the proposal is controversial, the SEC may adopt proxy access rules in time for the 2010 proxy season. Companies may wish to consider taking the following actions now:

- Consider amending advance notice bylaws. The proposed deadline for filing a Schedule 14N and nominating a candidate is the deadline established by a company's advance notice bylaw (or, in the absence of such a bylaw, 120 days before the first anniversary of the date on which the company mailed its proxy statement for the prior year's annual meeting). The process that would be used to determine whether a company can exclude a stockholder nominee requires a minimum of about 110 days and so should begin about 150 days before the date of the stockholders' meeting. Most advance notice bylaws currently have a deadline that is much closer to the date of the meeting. Given the lead time associated with a bylaw amendment, companies should review their advance notice bylaws now and consider whether any modifications are appropriate.
- Review majority voting bylaws. In recent years, many companies have adopted a majority voting standard for uncontested elections. Under most majority voting bylaws, plurality voting applies when there are more nominees than board vacancies. Given the lead time associated with a bylaw amendment, companies should review their bylaws to ensure that plurality voting applies in contested elections.
- Consider re-energizing investor relations programs. To the extent that companies have contact with their institutional stockholders, these relationships are often with the person who monitors the institution's investment in the company. A different person may vote the

institution's shares. The adoption of Rule 14a-11 would likely increase the number of election contests. Companies should consider the adequacy of their current investor relations programs, whether they have adequate information on the composition of their stockholder base, and whether to take action now to improve their relations with the decision-makers at the institutions that hold their shares.

- Consider submitting a comment letter. The SEC's proposing release contains hundreds of questions on which the Commission invites comment. Given the controversy associated with these proposals, companies should consider taking advantage of the comment period, to ensure that the SEC is aware of their views. Companies may comment individually or as part of a trade association. Comments are due by August 17, 2009.

<sup>1</sup> Facilitating Shareholder Director Nominations, Securities Act Release No. 33-9,046, Exchange Act Release No. 34-60,089, 74 Fed. Reg. 29,024 (June 18, 2009), *available at* <http://sec.gov/rules/proposed/2009/33-9046.pdf>.

<sup>2</sup> Foreign private issuers are not subject to the Exchange Act proxy rules and so will not be subject to Rule 14a-11.

<sup>3</sup> If there was no meeting in the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, the company would be required to file a Form 8-K when it determines the anticipated date of its meeting, and the stockholder or group would be required to file the Schedule 14N "a reasonable time" before the company mails its proxy materials.

<sup>4</sup> The exchanges' independence standards typically contain both objective and subjective components. For example, under the New York Stock Exchange's rules, no person qualifies as "independent" if the person, or any of his or her immediate family members, received more than \$120,000 in direct compensation from the company in any 12-month period within the last three years (subject to certain exceptions, including director's fees). This is an example of an "objective" independence component that would be covered by the certification.

<sup>5</sup> As proposed, Exchange Act Rules 14a-3 to 14a-6 (other than paragraphs 14a-6(g) and 14a-6(p)), 14a-8, 14a-10, and 14a-12 to 14a-15 would not apply to a solicitation by or on behalf of a stockholder, so long as any written communication contained only limited information related to the formation of the nominating group.

<sup>6</sup> As proposed, Exchange Act Rules 14a-3 to 14a-6 (other than paragraphs 14a-6(g) and 14a-6(p)), 14a-8, 14a-10, and 14a-12 to 14a-15 would not apply to communications that meet these criteria. These communications would be subject to Rule 14a-9.

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