
The SEC's New Proxy Access Rules

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Introduction

On August 25, 2010, by a 3-2 vote, the Securities and Exchange Commission adopted new proxy access rules. The new rules will allow stockholders of a public company who meet specified eligibility criteria to require the company to include the stockholders' nominees for election to the company's board of directors in the company's proxy materials. The new rules also permit a broader range of stockholder proposals relating to elections, create a new "Schedule 14N," amend Schedule 14A and Schedule 13G, add a new Form 8-K item and make other changes to the SEC's proxy rules.

The new rules take effect 60 days after their publication in the Federal Register, except that "smaller reporting companies" as of the effective date—companies with market capitalization less than \$75 million—will not be subject to new Rule 14a-11 until three years after the effective date. The effectiveness schedule means that most companies will be subject to the new proxy rules in the 2011 proxy season.

We previously published a [WilmerHale Public Company Alert](#) about the new proxy access rules. Below, we have provided a more detailed analysis of the rules.

Proxy Access Under Rule 14a-11

New Rule 14a-11 requires public companies to include, in their annual proxy statements and proxy cards, nominees for election to the board of directors nominated by stockholders or stockholder groups that meet the eligibility criteria set forth in the rule.

Rule 14a-11 applies to all companies subject to the SEC's proxy rules, including registered investment companies, controlled companies and voluntary registrants under Section 12(g) of the Exchange Act. Rule 14a-11 does not apply, however, to companies that have only debt securities registered under the Exchange Act. Foreign private issuers are not subject to the SEC's proxy rules and accordingly are not subject to Rule 14a-11. "Smaller reporting companies" as of the effective date of the new rules will not be subject to Rule 14a-11 until three years after the effective date. Rule 14a-11 also does not apply to a company if applicable state or foreign law or a company's governing documents prohibit stockholder nominations of directors altogether.

Stockholder Eligibility: 3% and Three-Year Ownership Requirements

Under Rule 14a-11, a stockholder or stockholder group is eligible for access to a company's proxy materials only if, on the date the stockholder or stockholder group files the new Schedule 14N giving notice of the director nomination, the stockholder or stockholder group:

- holds at least 3% of the total voting power of the company's securities entitled to be voted on the election of directors at the meeting; and
- has held these securities continuously for at least three years.

The stockholder or stockholder group must also continue to hold the securities through the date of the meeting.

The instructions to Rule 14a-11 and the adopting release provide detailed rules for calculating this 3% voting power threshold:

- stockholders may only count votes from securities over which they have both voting and investment power, either directly or through a third person;
- the adopting release explains that securities held in a pooled investment vehicle cannot be counted by the stockholder toward the threshold unless the stockholder has voting and investment power over the securities held in the pooled investment vehicle;
- stockholders cannot count securities that merely could be acquired, such as securities underlying options that are currently exercisable but have not yet been exercised;
- stockholders, however, may count securities they have loaned to others, if the stockholder or a person acting on the stockholder's behalf has the right to recall the loaned securities and will recall the loaned securities upon being notified that the stockholder's nominee will be included in the company's proxy materials;
- stockholders must subtract votes attributable to securities they, or a person acting on their behalf, have sold in a short sale that has not been closed out;
- stockholders must subtract votes attributable to securities they have borrowed; and
- in determining the total voting power for the denominator of the calculation, stockholders may rely on the company's most recent Form 10-K, Form 10-Q or Form 8-K, unless the stockholder knows or has reason to know that the total voting power disclosed in these reports is inaccurate.

The instructions to Rule 14a-11 contain detailed rules for determining whether the securities used to satisfy the minimum ownership requirement have been held continuously for the three-year holding period. These instructions take account of stock splits, reclassifications and similar

adjustments and permit stockholders to prove ownership through previously filed Schedules 13D and 13G, and Section 16 filings. The instructions to new Schedule 14N, discussed in more detail below, provide specific language that can be used to establish continuity of ownership when a stockholder is not the registered holder of the securities.

Nominee Requirements

Rule 14a-11 requires stockholder nominees to meet specified eligibility requirements:

- if the company, other than an investment company, is subject to the rules of a national securities exchange, the nominee must meet the “objective” portion of the applicable stock exchange’s independence standard;
- for investment companies, the nominee must not be an “interested person” as defined in Section 2(a)(19) of the Investment Company Act;
- the nominee, stockholder or stockholder group must not have an agreement with the company regarding the nomination, thus preventing collusion between the company and affiliated nominees but also potentially impeding negotiated settlements between stockholders and companies (unsuccessful negotiations, however, will not constitute an agreement with the company for this purpose); and
- the nominee’s candidacy or board membership must not violate applicable federal, state or foreign law or stock exchange rules. For example, the nominee’s election must not violate rules about eligible directors under the Federal Power Act, federal maritime laws, Department of Defense security clearance requirements, Department of State export licensing requirements, banking laws, FCC licensing requirements, state gaming licensing requirements, US government procurement regulations or antitrust laws.

Rule 14a-11 does not require a stockholder nominee to be independent of the stockholder. A stockholder nominee may be an employee or affiliate of the stockholder. If a board believes that the nominee would not meet the “subjective” portion of the applicable stock exchange’s independence standard, or would otherwise not meet independence or qualification standards included in the company’s corporate governance documents, the company may address these issues in its proxy statement. The new rules do not require nominees to complete company director and officer questionnaires in connection with their nomination.

Maximum Number of Nominees for Inclusion

Rule 14a-11 caps the maximum number of nominees a company must include in its proxy materials at one stockholder nominee or 25% of the total number of the company’s board of directors (rounded down), whichever is greater. Assuming the other requirements of Rule 14a-11 are met for a company, this means that:

- boards with seven members or less must include one proxy access nominee;

- boards with eight to 11 members must include up to two proxy access nominees; and
- boards with 12 to 15 members must include up to three proxy access nominees.

This cap applies regardless of whether a company has a staggered board, meaning that the calculation for staggered boards in any year will be based on the total size of the company's board, not the lesser number of directors being elected that year. Thus, if a company had a staggered board, with nine total seats and three directors elected each year, and no other Rule 14a-11 nominees on the board, then stockholders could nominate up to two of the three directors under Rule 14a-11.

If a company already has a Rule 14a-11 director on its board and the director's term extends past the election of directors for which the company is soliciting proxies, the company may count the director toward the cap. (This situation could arise if, for example, the company had a staggered board and a Rule 14a-11 nominee was elected at the prior year's annual meeting.) Additionally, if a nominee files a Schedule 14N before beginning communications with the company about the nomination, and afterward the company agrees to include the nominee in the proxy as an unopposed company nominee for the same year in which the proxy is filed, the company may count the nominee toward the cap.

A company cannot count a nominee toward the cap if the company has discussed the nomination with the stockholder before the stockholder files its Schedule 14N. For this reason, among others, incumbent directors who were initially nominated under Rule 14a-11 and are re-nominated by the company will typically not count toward the cap.

The new rules place no restriction on stockholders re-nominating failed nominees in subsequent years.

If more than one stockholder or stockholder group is eligible under Rule 14a-11 to include a nominee in a company's proxy materials, but the total number of nominees would exceed the cap, the nominee from the stockholder or stockholder group with the highest voting power percentage disclosed in the Schedule 14Ns has priority. Rule 14a-11 also specifies priorities in the event a stockholder or stockholder group withdraws or is disqualified.

Relationship between Rule 14a-11 and Proxy Contests

A stockholder may nominate a candidate under Rule 14a-11 even if the company is engaged in, or anticipates being engaged in, a concurrent proxy contest by a different stockholder. A stockholder may not rely on Rule 14a-11, however, if the stockholder is holding any of the company's securities with the purpose or effect of changing control of the company, or to gain more than the number of board seats permitted under Rule 14a-11. Stockholders may not act as participants in another person's solicitation in connection with the same election for which they are making a Rule 14a-11 nomination.

Schedule 14N: Certification, Disclosure and Other Requirements

Under Rule 14a-11, stockholders or stockholder groups that wish to nominate a director must comply with certification, disclosure and other requirements. The disclosures and certifications must be made on Schedule 14N. The stockholder or stockholder group must file the Schedule 14N on EDGAR and send or electronically transmit a copy to the company and file copies with any national securities exchange that lists the company's shares.

The disclosure and certification requirements in the Schedule 14N include the following:

- information about the 3% voting power calculation and proof of share ownership;
- a statement that the nominating stockholder or stockholder group intends to continue to hold the required minimum amount of securities through the date of the meeting;
- a statement about the stockholder or stockholder group's intent with respect to continued ownership of the securities after the election;
- disclosure about the nominee, including information on the nominee's business experience and the relationship between the nominee and the stockholder or stockholder group;
- a statement that the nominee consents to be named in the proxy statement and, if elected, serve on the board; and
- other informational statements, such as name and address of each nominating stockholder and the URL of any website address on which the nominating stockholder or group may publish soliciting materials.

Schedule 14N must be filed within a prescribed 30-calendar-day window. Rule 14a-11 defines this window as no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date that the company mailed its prior year's proxy materials (subject to exceptions if the company did not hold an annual meeting during the prior year or the meeting date has changed by more than 30 calendar days from the prior year, and in certain other specified circumstances).

The nominating stockholder must amend the Schedule 14N if any material change occurs with respect to the nomination or in the disclosure or certifications in the Schedule 14N. The nominating stockholder must also amend the Schedule 14N within 10 calendar days of the company announcing the final results of the election, in which case the amended Schedule 14N must state the nominating stockholder's intention with regard to continued ownership of its stock.

Requirements of a Company that Receives a Stockholder Nomination

Upon receipt of a Schedule 14N relating to a nomination under Rule 14a-11, a company must determine whether the stockholder or stockholder group's nomination meets the Rule 14a-11 eligibility requirements. The company must then notify the stockholder or stockholder group about

the company's determination.

If the company determines that it will include the nominee, the company must notify the stockholder or stockholder group upon making the determination, which must be at least 30 calendar days before the company files its definitive proxy statement. The company would then be required to include:

- in the company's proxy statement, information about the nominee and the nominating stockholder or stockholder group, including 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 adopting release notes that companies will be permitted to clearly designate nominees on the proxy card as company nominees or stockholder nominees, and the company's proxy materials may oppose the stockholder nominee's election. The proxy card may not contain boxes to vote for or against nominees as a group, but a company may solicit discretionary authority to vote for the company's nominees. A company need not file a preliminary proxy statement solely because it is including a stockholder nominee in the proxy statement.

If a company determines that the nominee is not eligible for inclusion under Rule 14a-11, or that the nominee's statement of support exceeds 500 words, it must notify the nominating stockholder or stockholder group no later than 14 calendar days after the close of the Rule 14a-11 nomination window. The notice must explain the company's basis for excluding the nominee or statement of support. Companies cannot exclude nominees merely because the company believes the Schedule 14N or the written statement is false or misleading. The nominating stockholder or group has 14 calendar days after receipt of the company's deficiency notice to correct any eligibility or procedural deficiencies and to respond to the company. In attempting to correct a deficiency, the nominating stockholder or group cannot 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 not to be included in the company's proxy materials.

If the company determines that the stockholder or stockholder group's response does not remedy the deficiency, the company must notify the SEC and explain the basis for its determination no later than 80 calendar days before the company files its definitive proxy materials. At this time, the company could seek a no-action letter from the SEC staff regarding the exclusion of the nomination. The company would provide a copy of the notice to the stockholder or stockholder group. The stockholder or group would have the right to 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 adopting release notes that the SEC staff "is committed to timely addressing these matters." The company bears the burden of demonstrating that it may exclude a nominee. If a stockholder's supporting statement exceeds 500 words, the company may exclude the supporting statement but must still include the nominee.

The adopting release summarizes this procedural timeline for excluding stockholder nominees with the following chart:

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 the Commission
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 Commission	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 Commission 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 Commission	Nominating shareholder or group may submit a response to the company's notice to the Commission staff
As soon as practicable	If requested by the company, Commission 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

Effectiveness Schedule

Although the new rules are effective 60 days after publication in the Federal Register, companies will be subject to Rule 14a-11 nominations only if the 30-day nomination window described above—the period from 150 calendar days to 120 calendar days before the anniversary of the company's previous proxy mailing date—is open for any period for the company after the effective date. Thus, if

the effective date of the new rules is more than 120 days prior to the anniversary of the mailing of the company's 2010 proxy materials, the company will be subject to stockholder nominations under Rule 14a-11 in the 2011 proxy season.

"Smaller reporting companies" as of the effective date will not be subject to Rule 14a-11 until 2013. The SEC staff is considering how Rule 14a-11 should apply to companies that become smaller reporting companies after the effective date. The changes to Rule 14a-8 described below, however, apply to smaller reporting companies at the same time they apply to other companies.

Stockholder Proposals under Amended Rule 14a-8(i)(8)

The SEC has also amended Rule 14a-8(i)(8), which previously provided that a company could exclude a stockholder proposal from its proxy materials if the proposal related to "a nomination or election for membership on the company's board of directors" or the "procedure for such nomination or election." Under the amendment, a stockholder proposal will only be excludable under Rule 14a-8(i)(8) if the proposal:

- would disqualify a nominee who is standing for election;
- would remove a director from office before the director's term expired;
- questions the competence, business judgment or character of a nominee or director;
- 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.

Amended Rule 14a-8(i)(8) will allow stockholders to propose charter or bylaw amendments to expand proxy access beyond what Rule 14a-11 allows, though not to contract it. For example, stockholders could propose procedures for stockholder nominations that require a shorter holding period or lower ownership threshold than Rule 14a-11. If approved, these procedures would be in addition to, not in substitution for, the process under Rule 14a-11. Companies are not permitted to opt out of Rule 14a-11.

Other Rule and Form Changes

In connection with Rule 14a-11, the SEC has made a number of corresponding rule changes.

New Rule 14a-2(b)(7) provides an exemption from the SEC's proxy solicitation rules for written and oral solicitations made in connection with the formation of a Rule 14a-11 nominating group. To use the new exemption, stockholders must not be holding their securities with the purpose or effect of changing control of the company or gaining more than the maximum number of seats allowed under Rule 14a-11. Compliance with the rule requires filing of written solicitation material with the SEC. A filing is also required upon commencement of oral solicitations.

New Rule 14a-2(b)(8) provides a new exemption from the SEC's proxy solicitation rules for stockholder solicitations in support of Rule 14a-11 nominees or against company nominees. This rule applies only after a stockholder receives notice from the company under Rule 14a-11 that the company will include the stockholder's nominee in the company's proxy materials. Compliance with the rule requires use of a specified legend and filing of written material with the SEC. Stockholders using this exemption may not, directly or indirectly, seek the power to act as a proxy for other stockholders.

A stockholder or group that owns more than 5% of a class of equity securities is required to report that ownership by filing a Schedule 13D. Exceptions permit a person to report its ownership on Schedule 13G if, among other things, the person acquired the securities with neither the purpose nor the effect of influencing control of the company. In connection with its adoption of Rule 14a-11, the SEC approved amendments to Schedule 13G and Rule 13d-1 so that stockholders will not lose their eligibility to file on Schedule 13G simply because they have nominated a person for election to the board pursuant to Rule 14a-11. The exemption from filing on Schedule 13D is available only for purposes of the nomination, and a stockholder would need to assess its eligibility to file on Schedule 13G after the election.

The adopting release states that activities other than those provided for under Rule 14a-11—for example, urging a company to consider strategic alternatives such as the sale of non-core assets or a leveraged recapitalization—would likely render the stockholder ineligible to file on Schedule 13G.

The SEC has not provided any exemptions from Section 16 filings (governing director, officer and 10% stockholder beneficial ownership reporting and short-swing profit recovery) in connection with the new rules. As a result, stockholders and stockholder groups will need to make their own assessment of whether Section 16 applies in their particular circumstances.

New Rule 14a-9(c) imposes securities law liability on nominees and stockholders who:

- cause to be included in a company's proxy materials;
- include in a Schedule 14N; or
- include in any other related communication

any statement which, at the time and in the light of the circumstances under which it is 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 any earlier communication with respect to a solicitation for the same meeting or subject matter which has become false or misleading. Rule 14a-11 explicitly provides that companies are not responsible for any information in a Schedule 14N or otherwise provided by a nominating stockholder that is included in the company's proxy materials. The adopting release explains that companies are not required to recirculate or correct proxy materials if they learn that the materials included false or misleading information provided by a nominating stockholder.

An amendment to Schedule 14A provides that information provided to the company in a notice from a nominating stockholder or stockholder group and included in the company's proxy materials is not incorporated by reference in any filings under the Securities Act, the Exchange Act or the Investment Company Act unless the company specifically incorporates the information in the filing.

An amendment to Rule 14a-5 adds a new disclosure requirement for companies, requiring them to disclose in their proxy statements the window for submitting Rule 14a-11 nominees for the next year's proxy statement.

New Rule 14a-18 provides that stockholders making director nominations for inclusion in the company's proxy materials pursuant to procedures under applicable state or foreign law or a company's governing documents must also use the new Schedule 14N. The Schedule 14N must be transmitted by the date specified by the company's advance notice provision or, where no such provision is in place, no later than 120 calendar days before the anniversary of the company's previous proxy mailing date.

Finally, under new Form 8-K Item 5.08, if a company did not hold an annual meeting in the previous year, or if the date of the annual meeting changes by more than 30 calendar days from the date of the previous year's meeting, the company must, within four business days after determining the anticipated meeting date, file a Form 8-K to disclose the date by which a stockholder or group must submit notice to include a nominee in the company's proxy materials under Rule 14a-11. The date must be a reasonable time before the company mails its proxy materials for the meeting. This new Form 8-K requirement applies to investment companies, despite the fact that investment companies are exempt from most Form 8-K filings.

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