

The SEC Adopts Final Proxy Access Rules

BY MICHAEL L. ZUPPONE & MEAGAN S. OLSEN

Overview

On August 25, 2010, the United States Securities and Exchange Commission (the "SEC") adopted comprehensive revisions to the federal proxy rules in order to facilitate shareholders' ability to exercise the rights afforded to them under state law to nominate and elect directors.¹ In summary, the new proxy access rules create a substantive federal right that requires public companies to include shareholder nominees in their proxy statements and proxy cards and thereby provide an inexpensive means for opposing management's slate and seeking the election of up to a quarter of the seats that make up the entire board. The SEC also adopted special exemptions from its proxy solicitation rules that allow shareholders to actively campaign in favor of election of their nominees.

The SEC's action follows the enactment on July 21, 2010 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") which explicitly authorized the SEC to adopt a process access regime.² The SEC's timing reflects its desire to have the proxy access rules effective for the 2011 proxy season. To that end, the new rules are effective November 15, 2010. Given the operation of the rule's 120-day notice requirement (which is tied to the mailing of the prior year's proxy statement), shareholders can now submit nominees to, and access the proxy statements of, public companies that first mailed their 2010 annual meeting proxy statements on or after March 16, 2010.

Proxy access has been a highly controversial topic since the SEC first proposed rules in 2003. The controversy did not abate within the SEC during the latest rulemaking process and the final rules were approved by a 3 to 2 split vote. The SEC received a large number of comments both supporting and opposing the proposed changes; however, the final rules were, for the most part, adopted substantially as proposed.³

Prior to the adoption of the proxy access rules, shareholders seeking to elect their own candidates to the company's board of directors were required to file and distribute their own proxy materials and engage in a costly proxy fight. Under new Rule 14a-11, significant, long-term shareholders of most public companies would be permitted to include a limited number of director nominees in such companies' proxy materials alongside the nominees of management, subject to certain limitations as described further below. This is commonly referred to as "proxy access." Rule 14a-11 is part of a series of new rules and amendments to existing rules adopted by the SEC to facilitate the various avenues of proxy access. The rights conferred upon shareholders pursuant to Rule 14a-11 are in addition to any proxy access afforded to shareholders under applicable state or foreign law or a company's governing documents. Given the substantive nature of the proxy access rights contained in Rule 14a-11, the notice requirements contained in existing advance notice bylaw provisions, to the

extent they are in conflict with the notice requirements of Rule 14a-11, will not be effective. Companies should review their bylaws and consider amending their advance notice provisions to clarify that notice provided pursuant to Rule 14a-11 is valid notice under their bylaws.

The SEC also adopted rules allowing shareholders to, under certain circumstances, include in the company's proxy materials shareholder proposals seeking to amend a company's governing documents to establish a procedure for the inclusion of shareholder director nominees in a company's proxy materials. If approved by a company's shareholders, such a proposal would create an additional means of proxy access for the company's shareholders.

Final Proxy Access Rules

The following is a general summary of the SEC's final proxy access rules.

New Rule 14a-11—Shareholder Director Nominations

General. New Rule 14a-11 applies to all companies subject to the proxy rules, except companies subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act"). Smaller reporting companies will not be subject to the requirements of Rule 14a-11 until the three year anniversary of the effective date of the rules.

Rule 14a-11 only applies when applicable state law or a company's governing documents do not prohibit shareholders from nominating a candidate for election as a director.

Shareholder Eligibility Requirements. In order to be eligible to have its nominee(s) included in the company's proxy materials pursuant to Rule 14a-11, a nominating shareholder or a nominating shareholder group (each referred to herein as a nominating shareholder) must provide the required notice to the subject company on new Schedule 14N ("Schedule 14N") and must meet each of the following requirements:

- The nominating shareholder must, as of the date it provides notice to the company on Schedule 14N, own at least 3% of the voting power of the company's securities eligible to be voted on the election of directors at the meeting.⁴
- The nominating shareholder must have held at least 3% of the voting power of the company's securities for at least three years as of the date of the Schedule 14N and must continue to hold the qualifying amount of shares through the date of the meeting.⁵
- The shareholder (or, in the case of a shareholder group, any member of the shareholder group) may not (i) be holding the shares with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the company's board of directors that exceeds the maximum number of nominees that the company would be required to include in the company's proxy statement under Rule 14a-11, nor (ii) have a direct or indirect agreement with the company regarding the nomination(s) prior to submitting the Schedule 14N.

In determining whether the requisite ownership threshold is met, nominating shareholders may rely on the following (unless they know or have reason to know that the relevant information is inaccurate):

- for companies other than investment companies, the company's most recent quarterly, annual or current report filed with the SEC;
- for companies that are "series" companies defined in Rule 18f-2 under the Investment Company Act of 1940, as amended (the "Investment Company Act"), the information contained in a Form 8-K that would be required to be filed by the series company in connection with the meeting where directors are to be elected, as discussed further under the heading "New Item 5.08 of Form 8-K" below; and
- for other investment companies, the investment company's most recent annual or semi-annual report filed with the SEC on Form N-CSR.

Notice on Schedule 14N. To have its nominee(s) included in a company's proxy materials, a nominating shareholder must provide written notice to the subject company on Schedule 14N no earlier than 150 days and no later than 120 days prior to the anniversary of the mailing date of the company's proxy statement in the prior year. If the subject company did not hold an annual meeting during the prior year, or if the meeting date changes by more than 30 days from the anniversary of the prior year's meeting date, then the nominating shareholder must provide and file its notice a reasonable time before the registrant mails its proxy materials, as disclosed in the Form 8-K required to be filed by the company pursuant to new Item 5.08 of such form, as discussed below. The Schedule 14N must be filed with the SEC on the same date it is provided to the company.⁶

Nominee Eligibility Requirements. A subject company is not required to include in its proxy materials any nominee whose candidacy or board membership would violate applicable state, federal or foreign law, the company's governing documents or the standards of the applicable securities exchange (other than director independence requirements that are based on the board's subjective determination that a director is independent which cannot, by their nature, be satisfied at the time a shareholder submits its nomination). If the company determines the candidacy or board membership of a nominee would result in such a violation, the company is required to give the nominating shareholder notice of such deficiency and allow the shareholder to cure the deficiency within the prescribed time period.

In addition, the nominee must satisfy the objective standards of director independence of the applicable securities exchange.

Rule 14a-11 does not place any restrictions on the relationship between the nominee and the nominating shareholder, but does deny access to any shareholder that has a direct or indirect agreement with the company regarding his or her nomination.

Number of Shareholder Nominees. A company that is subject to Rule 14a-11 is required to include in its proxy materials a total number of shareholder director nominees equal to the greater of (i) one and (ii) 25% of the total number of directors on the company's board.⁷ A director serving on a company's board who was a shareholder nominee pursuant to Rule 14a-11 and whose term continues after the date of the shareholder meeting for which the company is soliciting proxies will count against the maximum number of nominees that the company is required to include in its proxy materials for such meeting pursuant to Rule 14a-11.

If more than one eligible nominating shareholder submits nominees for inclusion in the company's proxy materials in reliance on Rule 14a-11 and timely files a notice on Schedule 14N, the company is required to include the eligible nominee(s) of the nominating shareholder with the most significant

holdings. If the number of eligible nominees submitted by such nominating shareholder is less than the maximum number of nominees that the company would be required to include in its proxy materials pursuant to Rule 14a-11, the eligible nominee(s) of the next most significant nominating shareholder would be included in the company's proxy materials. This process would continue until the maximum number of nominees required to be included is reached.

Procedure to Exclude a Proposed Shareholder Nominee From Proxy Materials. A subject company may exclude a nominating shareholder's nominee(s) from its proxy materials for a failure to meet the eligibility requirements or due to procedural deficiencies in the nomination. The company is required to notify the nominating shareholder of its determination within 14 days after the close of the period during which shareholders are permitted to submit nominations. The nominating shareholder has 14 days from receipt of the company's notice to respond to such notice and cure any deficiency. If, after receipt of such response, the company still determines that it may exclude the shareholder director nominee(s), it must provide notice to the SEC of the basis for such determination no later than 80 days before the company files its definitive proxy statement with the SEC and in such notice, may request that the SEC provide an informal statement of its views. The nominating shareholder is permitted to submit a response to the SEC within 14 days of the company's submission of such notice to the SEC. The company is required to provide to the nominating shareholder notice of whether it will include or exclude such shareholder's nominee(s) no later than 30 days before it files its definitive proxy statement with the SEC. All materials submitted to the SEC in connection with an attempt to exclude a nominee from a company's proxy materials would be publicly available immediately upon submission.

New Rule 14a-18—Requirements for Shareholder Nominees Submitted Pursuant to Applicable State or Foreign Law or a Company's Governing Documents

New Rule 14a-18 sets forth the disclosure requirements for shareholder director nominations made pursuant to applicable state or foreign law or a company's governing documents, rather than Rule 14a-11. Because the rules governing the eligibility requirements with respect to these types of nominations will be varied, many of the disclosure requirements for Rule 14a-11-based nominations may be inapplicable under the circumstances. Accordingly, the SEC believed that it was necessary to have separate disclosure requirements for these types of nominations. The SEC noted that the disclosure required by Rule 14a-18 "generally is consistent with that currently required in an election contest."

A shareholder submitting a nomination on state or foreign law grounds or pursuant to a procedure set forth in the company's governing documents is required to provide notice to the company on Schedule 14N by the date specified in the advance notice provision in the applicable statute or governing document or, where no such provision exists, no later than 120 days prior to the anniversary of the mailing date of the company's proxy statement in the prior year. If the subject company did not hold an annual meeting during the prior year, or if the meeting date changes by more than 30 calendar days from the anniversary of the prior year's meeting date, then the nominating shareholder must provide and file its notice a reasonable time before the registrant mails its proxy materials. The Schedule 14N must be filed with the SEC on the same date it is provided to the company.

As is the case with disclosures made in connection with Rule 14a-11 nominations, a nominating shareholder subject to the disclosure requirements of Rule 14a-18 would be liable for any materially false or misleading statements contained in the disclosures submitted to the company.

Schedule 14N Disclosure Requirements

As adopted by the SEC, in addition to requiring information about the identity of the nominating shareholder and the shareholder's nominee(s) and information about the nominating shareholder's beneficial ownership of shares of the company⁸, Schedule 14N also requires the following disclosure in connection with a nomination made under Rule 14a-11:

- a representation that the nominating shareholder (or each member of the nominating shareholder group) satisfies the eligibility conditions set forth in Rule 14a-11(b), including a statement regarding the nominating shareholder's beneficial ownership of the subject securities, intent to continue holding the securities through the date of the meeting and intention with respect to the ownership of shares following the meeting at which directors will be elected;
- a written statement from the registered holder of the shares beneficially owned by the nominating shareholder (or each member of the nominating shareholder group) or broker through which such shares are held, confirming that within seven days of the date of the Schedule 14N, the shareholder (or each member of the shareholder group) held shares representing at least 3% of the voting power of the company's stock continuously for three years;⁹
- disclosure regarding whether, to the best of the nominating shareholder's knowledge (or that of each member of the nominating shareholder group), the nominee meets the director qualifications imposed by the subject company's governing documents;
- with respect to a company other than an investment company, a representation that, to the best of the nominating shareholder's knowledge (or that of each member of the nominating shareholder group), the nominee meets the objective criteria for "independence"¹⁰ of the national securities exchange, if any, on which the company is listed or, in the case of a company that is an investment company, a representation that, to the best of the nominating shareholder's knowledge (or that of each member of the nominating shareholder group), the nominee is not an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act;
- disclosure regarding the nature and extent of any relationship between the nominating shareholder (or any member of the nominating shareholder group), the nominee and/or the company or any of its affiliates;¹¹
- a statement by the nominee that he or she consents to be named in the proxy materials and to serve on the subject company's board if elected;
- information about the shareholder nominee that is required to be disclosed under the proxy rules for a director nominee;
- information about the nominating shareholder (or each member of the shareholder group) consistent with what is currently required to be disclosed in a proxy statement with respect to a solicitation and solicitation participants in a contested election context;
- disclosure regarding whether the nominating shareholder (or any member of the nominating shareholder group) has been involved in any legal proceedings in the preceding ten years;

- the website address on which the nominating shareholder may publish soliciting materials, if any; and
- any statement in support of the shareholder nominee, which may not exceed 500 words, if the nominating shareholder elects to have such statement included in the subject company's proxy materials.

Schedule 14N also requires the nominating shareholder (or authorized member of the nominating shareholder group) to certify that, to the best of its knowledge, (i) it is not holding (or, in the case of a nominating shareholder group, no member of the group is holding) any of the subject company's securities for the purpose, or with the effect, of changing control of the subject company or to gain a number of seats on the company's board of directors that exceeds the maximum number of nominees that the company would be required to include in the company's proxy statement under Rule 14a-11; (ii) the nominating shareholder (or shareholder group) satisfies the requirements of Rule 14a-11 and (iii) the nominee satisfies the requirements of Rule 14a-11.

Schedule 14N also prescribes the disclosure requirements for a nominating shareholder that is seeking to include a nominee in the company's proxy materials pursuant to applicable state or foreign law or the company's governing documents, which vary slightly from those described above.

A nominating shareholder is required to "promptly" file an amendment to its Schedule 14N whenever there is a material change in the information set forth in Schedule 14N.¹² The nominating shareholder is also required under the new rules to amend its Schedule 14N within 10 days of the company's announcement of the final results of the election disclosing its intention with respect to continued ownership of the subject company's securities.

The information included in the Schedule 14N for inclusion in the subject company's proxy materials are subject to new Rule 14a-9(c), discussed below, which prohibits false and misleading statements by a nominee or nominating shareholder in connection with the shareholder nomination of a director.

New Rule 14a-9(c) —Prohibition Against False or Misleading Statements By A Nominee, Nominating Shareholder or Nominating Shareholder Group In Connection With Nomination

The SEC adopted new Rule 14a-9(c) pursuant to which shareholder nominees, nominating shareholders and members of nominating shareholder groups are prohibited from making statements in Schedule 14N or any related communication (regardless of whether such statement is subsequently included in the company's proxy statement) that is false or misleading with respect to any material fact, or omits any material fact necessary to make the statements therein not false or misleading. Rule 14a-9(c) applies in the context of Rule 14a-11 nominations as well as shareholder nominations made pursuant to applicable state or foreign law or the subject company's governing documents. The subject company is not responsible for any information included in the company's proxy statement which was provided by a nominee, nominating shareholder or nominating shareholder group.

Amendments to Schedule 14A

The SEC amended Schedule 14A to require a company to include most of the information submitted by a nominating shareholder on Schedule 14N in the company's proxy materials, including the nominating shareholder's statement in support of its nominee or nominees.¹³

New Rule 14a-2(b)(7)—Exemption From Proxy Rules for Written or Oral Solicitations in Connection With the Formation of a Nominating Shareholder Group Pursuant to Rule 14a-11

The SEC adopted a new exemption from the proxy solicitation rules (other than Rule 14a-9, which prohibits false and misleading solicitations) to permit nominating shareholders to assemble a group. Specifically, the exemption allows written and oral communications by a nominating shareholder in connection with the formation of a shareholder group pursuant to Rule 14a-11¹⁴, provided that such shareholder is not holding its shares with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the company's board of directors that exceeds the maximum number of nominees that the company would be required to include in the company's proxy statement under Rule 14a-11.

Any written communication made in reliance on this exemption must be limited to the following content:

- a statement of the each soliciting shareholder's intent to form a nominating shareholder group to nominate a director pursuant to Rule 14a-11;
- identification of, and a brief statement regarding, the potential nominee(s) or, where no nominee(s) has been identified, the characteristics of the nominee(s) that the shareholder intends to nominate, if any;
- the percentage of voting power of the subject company's entitled to vote at the election of directors that each soliciting shareholder beneficially owns or the aggregate percentage owned by any group of which the shareholder is a member; and
- information with respect to how shareholders may contact the soliciting party.

Any written soliciting material published, sent or given to shareholders pursuant to this exemption is required to be filed with the SEC by the nominating shareholder or nominating shareholder group under cover of Schedule 14N no later than the date it is first published, sent, or given to shareholders. Shareholders that are engaging in oral solicitation pursuant to this exemption are required to file a notice of commencement of such solicitations on Schedule 14N no later than the date of the first communication made in reliance on this exemption. In either case, the company and the market will be contemporaneously informed of such communications activity.

If a shareholder relying on this exemption subsequently engages in solicitation for a non-Rule 14a-11 nomination in connection with the subject election (other than solicitations exempt under Rule 14a-2(b)(8) discussed below), or if such shareholder becomes a member of a group with persons engaged in soliciting or nominating activities with respect to the subject election, the shareholder may be deemed to have engaged in a non-exempt solicitation in violation of the proxy rules.

Rule 14a-2(b)(7) does not cover solicitations where shareholders are seeking to nominate a director under applicable state or foreign law or a company's governing documents. Shareholders would have to rely on other exemptions in these contexts, such as Rule 14a-2(b)(2), which exempts solicitations made by persons other than the subject company where the total number of persons solicited is not more than 10.

New Rule 14a-2(b)(8)—Exemption From Proxy Rules for Oral or Written Solicitations by or on Behalf of a Nominating Shareholder in Support of Its Rule 14a-11 Nominee(s)

The SEC adopted a second new exemption from its proxy solicitation rules (other than Rule 14a-9, which prohibits false and misleading solicitations) to permit nominating shareholders to actively campaign for the election of their nominees. The exemption allows oral or written solicitation by or on behalf of a nominating shareholder in support of a nominee included in the company's form of proxy in accordance with Rule 14a-11, provided that the soliciting party does not, at any time during such solicitation, seek the power to act as proxy for a shareholder and does not furnish or otherwise request, and does not act on behalf of a person who furnishes or otherwise requests, a form of revocation, abstention, consent or authorization. Rule 14a-2(b)(8) is the only exemption available to nominating shareholders for solicitations in support of their nominee(s) or for or against company nominees.

Any written communication made in reliance on this exemption must include the following information:

- The identity of the nominating shareholder (or each member of the shareholder group) and a description of such shareholder's direct or indirect interests, by security holdings or otherwise; and
- A specified legend that, among other things, advises shareholders to read the subject company's proxy statement because it contains important information.

A nominating shareholder may commence solicitations and may rely on this exemption following receipt of notice from the subject company that such shareholder's nominee(s) will be included in the company's proxy materials.

Any soliciting material published, sent, or given to shareholders in reliance on this exemption must be filed by the nominating shareholder with the SEC under cover of Schedule 14N no later than the date the material is first published, sent, or given to shareholders and must at the same time be filed with or mailed to each national securities exchange upon which any class of securities of the registrant is listed and registered.

As is the case with Rule 14a-2(b)(7), if a shareholder relying on the exemption under Rule 14a-2(b)(8) subsequently engages in solicitation for a non-Rule 14a-11 nomination in connection with the subject election, or if such shareholder becomes a member of a group with persons engaged in soliciting or nominating activities with respect to the subject election, the shareholder may be deemed to have engaged in a non-exempt solicitation in violation of the proxy rules.

Like Rule 14a-2(b)(7), Rule 14a-2(b)(8) does not cover solicitations where shareholders are seeking to nominate a director under applicable state or foreign law or a company's governing documents. Shareholders would have to rely on other exemptions in these contexts, such as Rule 14a-2(b)(2), which exempts solicitations made by persons other than the subject company where the total number of persons solicited is not more than 10.

Amendment of Rule 14a-4 to Prohibit Voting for a Company's Nominees as a Group When Shareholder Nominees Are Included on the Proxy Card

The SEC has amended Rule 14a-4 to provide that if a shareholder nominee¹⁵ is included on a company's proxy card, the company is not permitted to group management nominees together and give shareholders the ability to vote for (or withhold authority to vote for) all management nominees as a group. As amended, Rule 14a-4 requires companies to design their forms of proxy card so that each company and shareholder nominee can be voted on separately.

Amendment of Rule 14a-6 to Provide That Preliminary Proxy Materials Do Not Need to Be Filed Because a Proxy Statement Contains a Shareholder Nominee

The SEC amended Rule 14a-6 to provide that a company is not required to file preliminary proxy materials merely because those materials contain a director that has been nominated pursuant to Rule 14a-11, applicable state or foreign law, or a company's governing documents. Accordingly, proxy materials that include a shareholder nominee may be filed in definitive form and would not be subject to SEC staff review, provided that such materials did not contain some other proposal requiring the filing of preliminary proxy materials.

Amendment of Rule 13d-1 to Allow Passive Investors to Continue to File Schedule 13G Filings When Using Rule 14a-11

Any person who is directly or indirectly the beneficial owner of more than 5% of a class of equity securities of an issuer that is registered under Section 12 of the Exchange Act must report that ownership on a Schedule 13D. In determining whether the 5% ownership threshold is triggered, Rule 13d-5(b)(1) provides that, when two or more persons act together for the purpose of acquiring, holding, voting, or disposing of equity securities of an issuer, the group formed thereby will be deemed to have acquired beneficial ownership of all equity securities of that issuer beneficially owned by all members of the group. It would appear that persons would be acting together for the purpose of voting their securities in connection with the formation of a nominating shareholder group. Accordingly, the security holdings of all members of a nominating shareholder group would be aggregated in determining the 5% threshold for filing a Schedule 13D in addition to being aggregated for purposes of determining whether Rule 14a-11's ownership requirements are met.

Certain 5% beneficial owners qualify to use an abbreviated Schedule 13G, which has significantly reduced disclosure requirements from those required by Schedule 13D. In order to use a Schedule 13G, among other things, an investor must have acquired the subject securities with neither the purpose nor the effect of changing or influencing control of the company.

The SEC has amended Rule 13d-1 to provide an exception to the requirement to file a Schedule 13D (thereby permitting the filing of a Schedule 13G) for activities of a nominating shareholder or shareholder group undertaken solely in connection with such shareholder's or group's Rule 14a-11 nomination. This exception is not available if a nominating shareholder or nominating shareholder group submits its nomination pursuant to applicable state or foreign law or a company's governing documents because, unlike Rule 14a-11, the applicable provisions in those circumstances may not limit the number of board seats for which a shareholder or group of shareholders may nominate candidates or include a requirement that the nominating shareholder or shareholder group lack the intent to change control of the company or gain more than a limited number of board seats.

The formation of a group can have implications under poison pills, debt covenants and other agreements that incorporate the Exchange Act's definition of a "group."

No Relief From Section 16 Requirements for Nominating Shareholder Groups

Under Section 16 of the Exchange Act and the rules promulgated thereunder, 10% beneficial owners of any class of equity security registered under the Exchange Act and each director and officer of the issuer of such security are:

- required to file Section 16 beneficial ownership reports;
- subject to disgorgement of “short-swing profits” (generally, “profits” made from the purchase and sale of securities made within six months of one another); and
- generally prohibited from short selling equity securities of that issuer.

Citing the fact that the 3% threshold required to use Rule 14a-11 is significantly lower than the 10% threshold that triggers ownership reporting obligations under Section 16, the SEC declined to amend Section 16 to exclude shareholder groups formed solely for purposes of nominating a director pursuant to Rule 14a-11 or conducting soliciting activities in connection therewith.

New Item 5.08 of Form 8-K

In connection with the adoption of the proxy access rules, the SEC adopted an amendment to Form 8-K which requires a company to disclose, pursuant to Item 5.08 of the form, a timetable for submission of shareholder director nominations where the company did not hold an annual meeting in the prior year or if the date of the meeting has changed by more than 30 days from the anniversary of the prior year’s meeting. Under these circumstances, a company must file, within four business days of determining its anticipated meeting date, a Form 8-K disclosing the date by which shareholders must submit a notice to include a director nominee in the company’s proxy materials, which date must be a reasonable time before the subject company mails its proxy materials. Companies that are “series companies” as defined in Rule 18f-2 under the Investment Company Act are also required to disclose the number of shares outstanding and entitled to vote for the election of directors at the shareholder meeting as of the end of the most recent calendar quarter.

The failure to file the required Form 8-K pursuant to Item 5.08 thereof would result in the company not being current or timely for purposes of the resale of securities under Rule 144 under the Securities Act of 1933, as amended, and determining the company’s eligibility to use Form S-3.

Changes to the SEC’s Shareholder Proposal Rules to Facilitate Alternative Proxy Access Regimes

As discussed in our prior client alert,¹⁶ Rule 14a-8(i)(8) previously permitted a company to exclude a shareholder proposal from its proxy statement “[i]f the proposal relates to a nomination or an election for membership on the company’s board of directors . . . or a procedure for such nomination or election.” Pursuant to this provision, companies were permitted to exclude shareholder proposals that would result in an immediate election contest or would set up a process pursuant to which shareholders could conduct an election contest in the future.

The SEC amended Rule 14a-8(i)(8) to disallow companies from excluding shareholder proposals seeking to amend a company’s governing documents to provide proxy access to shareholders for the purpose of nominating directors. As amended, Rule 14a-8(i)(8) still permits a company to exclude from its proxy materials shareholder proposals seeking to amend the company’s governing documents to allow proxy access on other bases set forth in Rule 14a-8, including if such proposal would conflict

with Rule 14a-11 (*i.e.*, proposals that would preclude nominations by shareholders that would otherwise qualify to have their nominee included in the company's proxy statement under Rule 14a-11) or cause the company to violate any applicable state, federal or foreign law.¹⁷ Accordingly, the amendments to Rule 14a-8(i)(8) could facilitate a proxy access regime totally separate from that provided in Rule 14a-11 and with perhaps lower ownership thresholds and a shorter holding period than those in proposed Rule 14a-11.

The SEC also adopted amendments to Rule 14a-8(i)(8) which codify prior SEC staff interpretations. As amended, Rule 14a-8(i)(8) permits a company to exclude a shareholder proposal if it:

- would disqualify a nominee that is standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, character, or business judgment of one or more nominees or directors;
- nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, applicable state or foreign law, or the company's governing documents; or
- could otherwise affect the outcome of the upcoming election of directors.

Conclusion

Proxy access will enable activist investors to pursue board representation more easily and at substantially reduced cost. Certain institutional investors that have vocally supported proxy access have begun to organize themselves to take advantage of the new rules. It was recently reported that the California Public Employees' Retirement System (CalPERS) has taken steps to assemble a pool of qualified directors that it can nominate pursuant to the proxy access rules. With the elimination of broker discretionary voting, which is now mandated by the Dodd-Frank Act, the vote represented by institutional investors (and the recommendations of the proxy advisory firms) potentially becomes more important to director election outcomes, particularly if the retail investors' vote is underrepresented due to the failure of such investors to provide voting instructions to their brokers. If incumbents are challenged by shareholder nominees included in the proxy statement through proxy access, additional efforts to increase the participation of retail shareholders may be warranted.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Atlanta

Elizabeth H. Noe
404-815-2287
elizabethnoe@paulhastings.com

Hong Kong

Neil Torpey
852-2867-9902
neiltorpey@paulhastings.com

Joseph A. Sevack
852-2867-9920
josephsevack@paulhastings.com

Los Angeles

Robert R. Carlson
213-683-6220
robcarlson@paulhastings.com

Robert A. Miller, Jr.
213-683-6254
robertmiller@paulhastings.com

Meagan S. Olsen
213-683-6138
meaganolsen@paulhastings.com

New York

Jeffrey J. Pellegrino
212-318-6932
jeffreypellegrino@paulhastings.com

Keith D. Pisani
212-318-6053
keithpisani@paulhastings.com

Scott R. Saks

212-318-6311
scottsaks@paulhastings.com

Mark Schonberger

212-318-6859
markschonberger@paulhastings.com

William F. Schwitter

212-318-6400
williamschwitter@paulhastings.com

Michael L. Zuppone

212-318-6906
michaelzuppone@paulhastings.com

Orange County

Stephen D. Cooke
714-668-6264
stephencooke@paulhastings.com

John F. Della Grotta

714-668-6210
johndellagrotta@paulhastings.com

Palo Alto

Robert A. Claassen
650-320-1884
robertclaassen@paulhastings.com

Paris

Joel M. Simon
33-1-42-99-04-45
joelsimon@paulhastings.com

San Diego

Leigh P. Ryan
858-458-3036
leighryan@paulhastings.com

Teri O'Brien

858-458-3031
teriobrien@paulhastings.com

San Francisco

Jeffrey T. Hartlin
415-856-7024
jeffhartlin@paulhastings.com

Thomas R. Pollock

415-856-7047
thomaspollock@paulhastings.com

Gregg F. Vignos

415-856-7210
greggvignos@paulhastings.com

Shanghai

Jim Hildebrandt
86-21-6103-2709
jimhildebrandt@paulhastings.com

Tokyo

Kenju Watanabe
81-3-6229-6003
kenjuwatanabe@paulhastings.com

1 See SEC Release Nos. 33-9136, 34-62764 and IC-29384 <http://www.gpo.gov/fdsys/pkg/FR-2010-09-16/pdf/2010-22218.pdf> (the "Adopting Release"). For ease of presentation, we generally omit cross-references to various sections of the new rules or the Adopting Release.

2 For more information concerning the corporate governance aspects of the Dodd-Frank legislation, see the July 2010 Stay Current entitled "The Dodd-Frank Act: Public Companies Subject to Far-Reaching Corporate Governance Reforms," which can be accessed at: http://www.paulhastings.com/assets/publications/1674.pdf?wt.mc_ID=1674.pdf.

3 See SEC Release Nos. 33-9046, 34-60089 and IC-28765 <http://www.sec.gov/rules/proposed/2009/33-9046.pdf> (the "Proposing Release"). For more information regarding the Proposing Release, see the July 2009 Stay Current entitled "The SEC's Proposed Proxy Access Rules, Related Delaware Law Changes, and Proposed Federal Corporate Governance

Legislation," which can be accessed at:

http://www.paulhastings.com/assets/publications/1366.pdf?wt.mc_ID=1366.pdf.

- 4 Members of a shareholder group are permitted to aggregate their shares for purposes of determining whether the threshold is met.
- 5 In the case of a shareholder group, each member of the group must have held the amount of securities that are used to satisfy the ownership threshold continuously for the required holding period.
- 6 In order to allow shareholders sufficient time to submit to the notice to the company and file the notice with the SEC on the same date, the SEC adopted an amendment to Regulation S-T to provide that a Schedule 14N filed on or prior to 10:00 p.m. Eastern time will be deemed to have been filed on the date it was transmitted to the SEC.
- 7 Where 25% of the board is not a whole number, the maximum number of shareholder nominees required to be included in a company's proxy materials is the closest whole number below 25%.
- 8 The nominating shareholder is required to disclose the portion of its reported voting power that is derived from securities, if any, that have been loaned or sold in a short sale that is unsettled.
- 9 This statement is not required if the nominating shareholder is the registered holder of the shares or if the nominating shareholder incorporates by reference into the Schedule 14N a Schedule 13D or Schedule 13G or one or more Forms 3, 4 or 5 or amendments thereto as evidence of its ownership of shares.
- 10 The shareholder nominee is only required to meet the exchange's general objective standards for independence and is not required to meet any heightened standard of independence applicable to audit committees. At the time the nomination is submitted, the shareholder nominee is not required to meet any subjective standard of independence (e.g., the NYSE has an independence standard, which, among other things, requires the board of directors to make an affirmative determination that an independent director has no "material relationship" with the subject company; a nominating shareholder is not required to represent that the nominee meets this subjective standard).
- 11 In the Adopting Release, the SEC provides the following examples of relationships that are required to be disclosed: (i) any interest (direct or indirect) in any contract or agreement between the nominating shareholder (or any member of the nominating shareholder group), the nominee and/or the company or any of its affiliates; (ii) any material pending or threatened litigation involving the nominating shareholder (or any member of the nominating shareholder group) or the nominee and the subject company or its affiliates; and (iii) any other material relationship between the nominating shareholder (or any member of the nominating shareholder group), the nominee and/or the company or any of its affiliates that is not otherwise disclosed.
- 12 In the Adopting Release, the SEC noted that it views the withdrawal of a nominating shareholder (or any member of the nominating shareholder group) or nominee and the reasons for such withdrawal as a material change. In addition, the SEC stated that it also views the agreement by the company and a nominating shareholder to include the nominating shareholder's nominee as a company nominee as a material change, noting that the nominee would no longer be a Rule 14a-11 nominee.
- 13 The company may exclude a statement in support of a nominee if such statement exceeds 500 words.
- 14 This exemption is not available to shareholders seeking to include a nominee in the company's proxy materials pursuant to applicable state or foreign law or a procedure set forth in the company's governing documents.
- 15 In the Adopting Release, the SEC noted that this provision applies to shareholder nominees included in a company's proxy materials pursuant to Rule 14a-11, applicable state or foreign law or the company's governing documents.
- 16 "Shareholder Proposals, Proxy Access and the Current Proxy Season," which can be accessed at the following link: http://www.paulhastings.com/assets/publications/1140.pdf?wt.mc_ID=1140.pdf.
- 17 Rule 14a-8(i)(3) permits exclusion of a shareholder proposal which is contrary to the SEC's proxy rules. Rule 14a-8(i)(2) permits exclusion of a shareholder proposal which would cause the company to violate any state, federal or foreign law to which it is subject.