

## SEC Proposes Rules to Increase Proxy Access by Shareholders

The SEC has proposed rule changes that would require, upon the occurrence of a specified triggering event, companies subject to the SEC's proxy rules, including investment companies registered under Section 8 of the Investment Company Act, to include in their proxy materials director nominees that are submitted by certain shareholders.<sup>1</sup> The proposed rule would not limit a company's ability to solicit proxies for its own slate of directors or its ability to oppose shareholder nominees.

The proposals follow recommendations made by the Division of Corporation Finance in its July 15 staff report, *Review of the Proxy Process Regarding the Nomination and Election of Directors*.

The text of the proposed rules is not yet publicly available. When the SEC publishes the proposed rules, we will distribute a more detailed *SEC Alert*.

### Triggering Events

Under the proposed rule, companies would be required to include shareholder nominees in their proxy materials only if the following triggering events have occurred within the previous two years and only where state law permits shareholders to nominate a candidate for election as a director:<sup>2</sup>

- one or more directors receives "withhold" votes from more than 35% of the votes cast with regard to one or more directors nominated by the company; or
- a shareholder proposal, which is submitted by a shareholder or group of shareholders that has held more than 1% of the company's voting securities for one year and requests that the company become subject to the proposed shareholder nomination procedure, receives support from a majority of votes cast on that proposal at an annual meeting.

If a triggering event occurs, the company would be required to include shareholder nominees in the company's proxy materials for the following two years.

Shareholders seeking control of the board of directors would not be entitled to nominate directors under the proposed rule.

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<sup>1</sup> Note that the proposed rule would not apply to foreign private issuers, as they are not subject to the SEC's proxy rules.

<sup>2</sup> Most states, including Delaware, allow shareholders to nominate director candidates.

## Qualification Requirements

### Nominating Shareholders:

If a triggering event occurs, only a shareholder or group of shareholders meeting the following qualification requirements would be entitled to nominate director candidates: The shareholder or group

- has beneficially owned more than 5% of the company's securities for at least 2 years
- intends to maintain that ownership through the annual meeting at which the related election will occur; and
- is eligible to file, and has filed a Schedule 13G evidencing its intent not to influence control of the company.

### Nominees:

The individuals nominated by the shareholder or shareholder group also must meet specified criteria including the following:

- compliance with applicable laws and regulations;
- satisfaction of objective independence standards of the NYSE, NASD or other SRO applicable to the company;
- absence of any specified relationships with the nominating shareholder or any member of the nominating shareholder group, such as being an affiliate or employee of, or receiving compensation from, the shareholder or group; and
- absence of any agreement between the nominating shareholder or any member of the nominating shareholder group and the company about the nomination of the nominee.

## Limitation on Number of Nominees Disclosed

The number of nominees a company would be required to include in its proxy materials would depend on the size of its board of directors:

Number of Board Members	Number of Nominees to Disclose
8 or fewer	1
Between 9 and 19	2
20 or more	3

In situations where a company receives more shareholder nominees than it is required to include in its proxy materials, the nominees included would be those put forward by the nominating shareholders with the greater security ownership.

## Other Requirements

The proposed rule would also:

- require that the company file with the SEC all soliciting materials and provide that Rule 14-9 (prohibition on soliciting proxies with misleading proxy materials) would apply to such material;
- make clear that a beneficial owner who acquires or holds a company's securities in connection with a nomination under the rule would not lose Schedule 13G eligibility solely as a result of making a nomination, soliciting proxies under the rule or having a nominee elected to the board
- exclude a nominating shareholder group from the definition of a 10% holder for Section 16 purposes provided that the group does not have the purpose or effect of changing control of the company, although an individual shareholder holding 10% or more would continue to be subject to Section 16.

### Alternatives to Rule Proposal

The SEC is also soliciting comments on the following two alternatives to the rule proposals described above: Limit the application of the rule to those companies that are defined as accelerated filers for purposes of the deadlines for filing periodic reports under the Exchange Act.

Include as a triggering event a company's failure to implement a proposal that was submitted under Rule 14-8 with regard to any topic by a shareholder who has held more than 1% of the company's outstanding shares for at least one year, which proposal had received a majority of votes cast with respect to such proposal at an annual meeting.

### Comment Period and Effective Date

There will be a 60 day comment period on the proposed rule. If adopted as a final rule, the SEC indicated that it may be effective for the 2004 annual meeting season. As a result, if the rule is adopted as proposed and any of the triggering events occurs at the 2004 annual meeting, qualified shareholders would be able to take advantage of the shareholder nomination process at the 2005 and 2006 annual meetings.

### Contact Information

If you have any questions or would like to learn more about these rules, please contact your usual legal advisor at Ropes & Gray.