

## The SEC Swiftly Adopts Proxy Access Rules Following Authorization Under the Dodd-Frank Act

At an open meeting held on August 25, 2010, after many years of debate, the Securities and Exchange Commission finally voted – in a 3 to 2 vote – in favor of proxy access. New Rule 14a-11 under the Securities Exchange Act of 1934 allows shareholders of public companies to include their nominees for election to the company's board in the company's proxy materials. The SEC also approved amendments to other proxy rules to facilitate proxy access, including a change to Rule 14a-8 that will allow shareholder proposals that would make proxy access even easier than the prescriptive regime that the SEC adopted.

A brief description of the final rules and associated amendments is provided below. The SEC's adopting release may be found at the SEC's web site at this [link](#).

### A. Summary of Rule 14a-11

Previously, a shareholder could not require a company to include the shareholder's director nominee(s) in the company's proxy statement or on management's proxy. Instead, a shareholder that wanted to propose a competing director or a slate of directors would have to bear the costs of launching a proxy contest and filing and circulating its own proxy materials. Under the new rule, if a shareholder or group of shareholders meets the criteria described below and follows the procedures prescribed by Rule 14a-11, the shareholder or group may include its nominee(s) for election alongside the company's nominees in the company's proxy materials.

### B. Companies to which Rule 14a-11 Applies

Rule 14a-11 applies to all companies that are subject to the proxy rules, including controlled companies, registered open-end and closed-end investment companies and business development companies, unless applicable state or foreign law or a company's bylaws or other governing documents prohibit shareholders from nominating candidates to the company's board of directors. However, the SEC has exempted from the application of Rule 14a-11 companies that are subject to the proxy rules solely because they have a class of debt securities registered pursuant to Section 12 of the Exchange Act. In addition, for smaller reporting companies, Rule 14a-11 will become effective three years after the date it becomes effective for all other companies.

## C. Ownership Threshold and Holding Period

In order for a shareholder or group of shareholders to require a company to include its nominee(s) in the company's proxy materials, the nominating shareholder or group must hold at least 3% of the total voting power of the company's securities that are entitled to be voted on the election of directors. Previously, the SEC had proposed to require ownership of between 1% and 5% of a company's securities depending on the size of the company, but the final rule contains a single ownership threshold regardless of the size of the company.

A nominating shareholder or group must have held the securities continuously for at least three years. This three-year holding period is a significant change from the initial proposal, which had called for a one-year holding period. The nominating shareholder or group must also represent that it intends to continue to hold those securities through the date of the shareholder meeting at which the election of directors will be voted upon.

If a nominating shareholder or group is a beneficial owner rather than a holder of record, the beneficial owner(s) must obtain a written statement from the record owner(s) verifying the nominating shareholder's or group's ownership of the requisite percentage of securities for the required duration or prove ownership by providing copies of previously filed reports under Section 13(d) or Section 16 of the Exchange Act.

## D. Number and Qualifications of Candidates

A nominating shareholder or group may request inclusion of nominees equal to 25% of the company's board of directors but no less than one. If the company has a staggered board, any director previously elected to the board under Rule 14a-11 whose term extends beyond the meeting for which inclusion is then sought counts in the calculation of the 25% limitation. If there are multiple nominating shareholders or groups, the company must include the nominees of the shareholder(s) or group(s) holding the highest percentage of the company's voting power until the 25% cap is met.

If a company's securities are listed on a stock exchange, candidates nominated by a nominating shareholder or group must meet the objective independence standards of such stock exchange. A shareholder nominee need not, however, be independent from the nominating shareholder or group, and a shareholder nominee need not meet any more stringent independence requirements imposed by the company. In the case of a registered investment company, a shareholder nominee need not be included in the company's proxy materials if he or she is an "interested person" of the investment company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.

## E. Shareholder Disclosure and Representations

In order to include nominee(s) in a company's proxy materials, a nominating shareholder or group must file with the SEC, and provide to the company, a Schedule 14N, notifying the company of its intent to require inclusion of its nominee(s) in the company's proxy materials pursuant to Rule 14a-11 and containing disclosure that the Schedule requires. A nominating shareholder or group must submit the Schedule 14N no earlier than 150 days and no later than 120 days before the anniversary of the date a company mailed its proxy statement for the prior year's annual meeting. If a company

did not conduct an annual meeting of shareholders in the prior year or if the date of the annual meeting changes by more than 30 days from the prior year, then the Schedule 14N must be filed a reasonable time before the company mails its definitive proxy statement, the deadline for such reasonable time having been specified by the company in a Form 8-K filed within four business days after the company determines the anticipated meeting date pursuant to new Item 5.08 to Form 8-K.<sup>1</sup>

The Schedule 14N must contain information about the nominating shareholder or group and its nominees similar to that which would be required in an opposition proxy statement in a contested director election. The Schedule 14N must also include representations about the nominating shareholder's or group's ownership and duration of holding period described above and, if applicable, a statement of the record owner as to the nominating shareholder's or group's ownership if the nominating shareholder or group is not the holder of record. Additionally, a nominating shareholder or group must attest to its intention to hold the securities through the date of the shareholder meeting at which directors are elected and indicate its intentions with respect to its continued ownership following the election. Further, a nominating shareholder or group must certify in its Schedule 14N that it does not hold the securities of the company for the purpose, or with the effect, of changing the control of the company or in order to gain more than a limited number of board seats.

A nominating shareholder or group may also include in its Schedule 14N a supporting statement of up to 500 words with respect to each nominee. If a company determines to include a nominating shareholder's or group's nominees in its proxy materials, then, at least 30 days in advance of filing its definitive proxy statement, it must notify the nominating shareholder or group and must include such supporting statement from the Schedule 14N in its proxy materials sent to shareholders. The company will not be liable for any information provided by the nominating shareholder or group that is included in the company's proxy materials.

## F. Exclusion of Shareholder Nominees

A company may exclude nominees for any of the following reasons:

- the nominating shareholder or group has not complied with Rule 14a-11;
- the nominee does not meet the applicable eligibility requirements of Rule 14a-11; or
- inclusion of the nominee or nominees would result in the company exceeding the maximum number of nominees the company is required to include in its proxy materials under Rule 14a-11.

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<sup>1</sup> This requirement applies to registered investment companies, as well as to other issuers. In adopting this requirement, the SEC noted that requiring registered investment companies to disclose information on Form 8-K is a departure from past practice, but is justified because the information required to be disclosed is "important information that should be filed with the [SEC] and accessible on EDGAR rather than merely disclosed on a Web site or in a press release." In addition to disclosing the information discussed above, a registered investment company that is a series company (as defined under the Investment Company Act of 1940) must also disclose under Item 5.08 of Form 8-K the total number of shares that are outstanding, including shares of other series of the same series company, and entitled to vote for the election of directors (or if votes are cast on a basis other than one vote per share, then the total number of votes entitled to be voted and the basis for the allocation of such votes) at a meeting of shareholders as of the end of the most recent calendar quarter.

In each case, if a company determines to exclude a nominee, it must follow certain procedures prescribed by Rule 14a-11:

- Within 14 days of the close of the window period for submission of nominations under Rule 14a-11 (i.e., 120 days prior to last year's mailing), a company must notify the nominating shareholder or group of its intention to exclude the nominee(s) and the reasons for exclusion (e.g. which eligibility requirements have not been satisfied).
- The company must afford the nominating shareholder or group an opportunity to respond and to correct any eligibility or procedural deficiencies identified in the company's notice, though neither the composition of the nominating group nor the nominee(s) may be changed to correct a deficiency (other than removal of a nominee or nominees if the number of nominees exceeds the 25% cap).
- If the shareholder fails to correct the deficiency or deficiencies within 14 days and the company still has a basis for exclusion of the nominees, then the company would be required to submit a notice to the staff of the SEC specifying the basis for its determination that a shareholder's nominees may be excluded. The notice to the SEC must precede the filing of the company's definitive proxy statement by at least 80 days and must be simultaneously provided to the nominating shareholder or group.
- Within 14 days of the company's submission of the notice to the SEC, the nominating shareholder or group may submit a letter to the SEC staff responding to the company's notice.
- If requested by the company, the staff of the SEC would, in its discretion, provide its informal views in a no-action letter to the company and the nominating shareholder or group.
- Following receipt of the staff's response, the company must provide the nominating shareholder or group with notice of its intention to include or exclude the shareholder's or group's nominees.

Companies will need to pay scrupulous attention to time periods, particularly if a company plans to move its meeting date forward from the prior year.

## G. Formation of a Nominating Group and Communications with Other Shareholders

Amendments to certain existing proxy rules will permit a shareholder considering using Rule 14a-11 to solicit other shareholders, orally or in writing, to form a nominating group, as long as the shareholder does not hold its securities for the purpose, or with the effect, of changing the control of the company or in order to gain more than the number of board seats permitted under Rule 14a-11. In addition, in a significant concession to opponents of proxy access, the nominating shareholder or group may not conduct any solicitation in connection with the election of directors other than pursuant to Rule 14a-11 and the exception described in the following paragraph. Additionally, any written materials used for such purpose must contain limited information and certain legends, and must be filed with the SEC on the date of first use.

A nominating shareholder or group is also permitted by these amendments to communicate orally or in writing in support of its nominee(s) or against the company's nominees provided that the nominating shareholder or group does not seek the power to act as proxy for a shareholder and does

not conduct any solicitation in connection with the election of directors other than pursuant to Rule 14a-11.

## H. Amendment of Rule 14a-8

The amendment of Rule 14a-8(i)(8) eliminates the authority of a company to exclude from its proxy materials shareholder proposals that seek to (i) include a nominee or nominees for election to a company's board of directors or (ii) amend or request amendment to a company's bylaws or other governing documents relating to director nomination procedures or disclosures related to nominations by shareholders.

As amended, Rule 14a(8)(i)(8) will only allow a company to exclude from its proxy materials shareholder proposals that relate to the procedures concerning the election of directors if one of the following conditions is met:

- The shareholder proposal would disqualify a nominee who is standing for election;
- The shareholder proposal would remove a director from office before the expiration of his or her term;
- The shareholder proposal questions the competence, business judgment or character of a nominee or director;
- The shareholder proposal nominates a specific person for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision or the company's bylaws or other governing documents; or
- The shareholder proposal could otherwise affect the outcome of the upcoming election of directors.

## I. Impact on Schedule 13G Eligibility and Affiliate Status

Certain beneficial owners of greater than 5% of a company's securities may file beneficial ownership reports on a Schedule 13G (as opposed to the more onerous Schedule 13D) if they acquired and hold the securities with neither the purpose nor the effect of changing or influencing the control of the company. The SEC has approved amendments to Rule 13d-1 to make clear that a shareholder or group of shareholders will not lose its Schedule 13G eligibility solely by submitting nominees under Rule 14a-11 or conducting a solicitation on behalf of such nominees. Although as a condition to proxy access a nominating shareholder must represent it has no control intent (as described above), this is a helpful clarification.

However, a shareholder will still need to consider, based on its particular facts and circumstances, whether its participation in a nominating shareholder group affects its "group" status under Section 13(d) and its beneficial ownership reporting under Section 16(a) of the Exchange Act.

Proxy access rules proposed in 2009 included a safe harbor providing that a shareholder or group of shareholders would not be deemed an "affiliate" of the company solely by submitting nominees under Rule 14a-11, conducting a solicitation on behalf of such nominees or by virtue of the election of such shareholder's or group's nominees. Stating that it did not believe the safe harbor would meaningfully facilitate use of Rule 14a-11, the SEC did not approve the inclusion of the safe harbor

in the final rules and instead indicated that shareholders using Rule 14a-11 will need to analyze their particular facts and circumstances to make a determination about their affiliate status.

## J. Effective Date

The final rules and amendments will take effect 60 days after publication in the Federal Register. Assuming, for example, effectiveness on November 1, 2010, proxy access would apply in the 2011 proxy season to any company that mailed its proxy statement on or after March 1, 2010 in connection with its 2010 annual meeting, with the window period for submission of nominations under Rule 14a-11 truncated for those companies with mail dates between March 1 and March 30, 2010.

## K. What to do now

Although there likely isn't much that companies need to do at this moment to prepare for proxy access, it would be prudent for companies to consider one or more of the following actions:

- *Review of Advance Notice By-laws.* Many advance notice by-laws have a 90/60 day advance trigger, which may not synch well with the 150/120 provision in Rule 14a-11. Companies may need to make a change to their by-laws to accommodate the new rule.
- *Review Shareholder Nomination Procedures.* Companies are currently required to disclose in their proxy statements the procedures by which shareholders can submit nominees for director. Companies should review these procedures to see if changes will be required as a result of proxy access.
- *Prepare for Shareholder Engagement.* Companies should be prepared to engage with investors who are interested in nominating candidates pursuant to Rule 14a-11.

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If you would like to discuss these or any other governance or securities law matters, please contact any member of Ropes & Gray's Securities & Public Companies practice or your usual Ropes & Gray advisor.