

PUBLICATION

SEC Adopts Proxy Access Rules

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On August 25, 2010, in a 3-to-2 vote by the SEC Commissioners, the SEC adopted changes to the federal proxy rules facilitating the rights of shareholders of public companies in the process of nominating and electing members to their companies' boards of directors. The SEC proposed the proxy access rules in May 2009. The SEC acted quickly, as expected, in adopting the changes after the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in July 2010. The Dodd-Frank legislation explicitly authorized the SEC to make rules addressing shareholder access to proxy materials.

The centerpiece of the new rules, Rule 14a-11 of the Securities Exchange Act of 1934 (Exchange Act), empowers shareholders or a group of shareholders, in the aggregate, who hold at least three percent of the total voting power entitled to vote in the election of directors at the annual meeting and who have held their shares for at least three years to include director nominees in company proxy materials. In addition, the SEC voted to amend Rule 14a-8 to allow shareholders to propose additional procedures that provide greater access than the new Rule 14a-11. The new rules are mandatory, prohibiting companies from opting-out or adopting less restrictive proxy access procedures.

The new rules will apply to all public companies, including registered investment companies, but not to foreign private issuers or companies with registered debt securities only. Except with respect to smaller reporting companies, the rules will take effect 60 days after publication in the Federal Register, in time for a majority of the companies' 2011 proxy season. Smaller reporting companies will not be subject to the new proxy rules until three years after the effective date for all other public companies. Key provisions in the proxy access rules are summarized below.

Proxy Access Under Rule 14a-11

Shareholders must meet the requirements summarized below to be eligible to take advantage of proxy access under the new Rule 14a-11:

Eligibility of Nominating Shareholders

- Nominating shareholders must (a) own, individually or in the aggregate with other shareholders acting together as a group, at least three percent of the voting power entitled to vote in the election of directors of the annual meeting, (b) own such amount continuously for at least three years, and (c) continue to own such amount through the annual meeting date. In the final rules, the SEC rejected the previously proposed tiered ownership threshold, which depended on the filer's status or net assets of an investment company, and also increased the holding period contained in the proposed rules from one year to three years.
- The calculation of the three percent ownership level excludes short sales of shares and borrowed shares to reach such ownership level. However, the nominating shareholder may count shares that it lends to others, as long as the shareholder has the right to recall the shares and will do so for the vote. The rule does not address hedging of shares other than through short sales.

- Nominating shareholders may not hold their shares with the purpose or effect of changing control of the company or gaining more seats on the board than the maximum provided for in Rule 14a-11 (as discussed below).

Eligibility of Nominee

- A nominee will be required to meet the objective, independent director standards of the stock exchange on which the shares of the company are listed, and their nomination or board membership must not violate any applicable federal or state laws or regulations.
- The rule will limit the number of directors nominated by shareholders in this manner to the greater of one director or 25 percent of the entire board of directors. If the number of shareholder nominees exceeds the number permitted to be nominated by Rule 14a-11, the nominee of the shareholder with more voting power, not the first shareholder to nominate, will be included in the company's ballot and described in the company's proxy statement. If the company's directors serve on a staggered board, then the shareholder nominees elected to serve on the board will be included in the calculation of the 25 percent cap for future annual meetings during the respective shareholder nominees' terms.

Nomination Procedure

- A nominating shareholder will be required to file a "Notice of Intent on Schedule 14N," which requires disclosure regarding the nominating shareholder's ownership and intent for holding the shares and may also include a supporting statement for its candidate or candidates. The nominating shareholder must also disclose whether, to his knowledge, his nominee satisfies the company's director eligibility requirements set forth in its governing documents, even though failure to meet such requirements will not disqualify a nominee for election.
- The time frame for submitting a nominee by filing a Schedule 14N will be no earlier than 150 days, and no later than 120 days, before the anniversary of the mailing date of the proxy statement for the company's prior annual meeting. Thus, assuming the rule becomes effective on November 1, 2010, shareholders of public companies, other than smaller reporting companies, will be able to take advantage of the new proxy access rule for the company's 2011 annual meeting if the company mailed its proxy materials on or after March 1, 2010 for its 2010 annual meeting.
- After giving a shareholder the opportunity to cure any perceived non-compliance issues and no later than 80 days before the definitive proxy statement is filed, the company will be able to challenge a nomination by providing notice to the SEC of its basis for excluding the nomination and seek no-action relief.

Rule 14a-8

In addition to Rule 14a-11, the SEC adopted amendments to Rule 14a-8 of the Exchange Act to permit shareholders to file proposals that seek more permissive access standards. Pursuant to Rule 14a-8(i)(8), shareholders will be able to propose to establish less restrictive eligibility requirements or procedures in the company's governing documents for the inclusion of shareholders' directors nominees in the company's proxy materials. Shareholders, however, will not be able to propose a more lenient threshold than Rule 14a-11 requires.

According to the SEC, the new rules emphasize the importance of facilitating shareholders' exercise of their state law right to nominate and elect directors of their choice. SEC Chairman Mary L. Schapiro describes the new proxy access regime for long-time significant shareholders as "a matter of fairness and accountability." However, opponents have given the SEC a number of objections. A number of companies have urged the SEC to allow shareholders to opt out of the proxy access procedures. Additionally, some groups have urged the

SEC to permit "private ordering" of proxy access procedures, which would allow companies to establish their own procedures to create proxy access under Delaware and other state corporate laws and regulations. The implementation of these proxy access rules will likely face challenges, especially by the U.S. Chamber of Commerce. Earlier this month, the Chamber retained counsel to review whether to file suit to block proxy access, and in a press release on August 25, 2010, David Hirschman, President and CEO of the Chamber's Center for Capital Markets Competitiveness stated that the "Chamber will carefully review the rule that was approved today and will continue to fight this flawed approach using every method available." In any case, the existence of proxy access creates the likelihood of fundamental change to the composition of a company's board of directors and the relationships between management and shareholders and should compel companies to strengthen investor relations.

The full text of the adopting release is available at: <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

If you have questions about this or any other securities-related issues, please contact your Baker Donelson attorney.