



## SEC Adopts New Proxy Rules Implementing Proxy Access

On August 25, 2010, the Securities and Exchange Commission adopted, by a 3-2 vote, amendments (the “Amendments”) to the federal proxy rules that will implement a system of “proxy access.” Under the Amendments, particularly new Rule 14a-11, a shareholder or group of shareholders meeting certain eligibility requirements can require public companies to include a limited number of director nominees selected by the eligible shareholder in the management proxy materials. Approval of the Amendments followed the enactment, in July, of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provided the SEC with explicit authority to make rules addressing shareholder access to company proxy materials.

As adopted, the Amendments contain a number of significant differences from the SEC’s June 2009 proxy access proposal (the “2009 Proposal”). Most significantly, the Amendments require that, in order to be eligible to submit a nominee, a shareholder, or group of shareholders, must have voting and investment power with respect to 3% of the total voting power of the company’s securities entitled to be voted on the election of directors and have held such investment and voting power continuously for three years. The 2009 Proposal would have (i) required staggered ownership thresholds of 1% for large accelerated filers, 3% for accelerated filers and 5% for all other covered filers, (ii) would have required a nominating shareholder to maintain ownership at the appropriate threshold for a minimum timeframe of only one year and (iii) would have permitted shares to count toward the minimum ownership threshold if the shareholder held either voting or investment power. Somewhat less significantly, the Amendments also impose a different rule than that contemplated by the 2009 Proposal for situations in which more than one eligible shareholder or group of shareholders has submitted a nominee or nominees. Under the Amendments, the shareholder or group of shareholders with the largest ownership stake will be entitled to have its candidate or candidates included. Under the 2009 Proposal, the first shareholder or group of shareholders to have submitted a candidate would have been given priority.

The Amendments will generally become effective 60 days after publication in the Federal Register. Whether the new rules will be applicable for a particular company’s upcoming proxy statement will depend in part on the date that the Amendments are published in the Federal Register and in part on the date on which the company mailed its proxy statement for last year’s annual meeting. The Amendments require that shareholders wishing to submit a candidate pursuant to the new rules must do so within a window period of no earlier than 150, and no later than 120, calendar days prior to the anniversary of the date that the company mailed its proxy materials for the prior year’s annual meeting. With respect to this upcoming proxy season, the SEC has made clear that eligible shareholders will be able to submit director nominees for inclusion in management proxy statements so long as this window period is open after the effective date of the rules.

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

A detailed discussion of the most significant provisions of the Amendments follows.

### **Companies Affected**

New Rule 14a-11 will apply to companies that are subject to the Exchange Act proxy rules, including registered investment companies. There is no exception for controlled companies and the rule will also apply to those companies that choose to voluntarily register a class of equity securities under Section 12(g). Smaller reporting companies will be subject to the rule, but on a delayed basis.

Rule 14a-11 will not apply to companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Exchange Act. In addition, because foreign private issuers are exempt from the SEC's proxy rules with respect to solicitations of their shareholders, Rule 14a-11 will not apply to these issuers.

### **Shareholder Eligibility**

As noted above, new Rule 14a-11 will require reporting companies to include in their proxy materials director nominees proposed by any owner of at least 3% of the total voting power of the company's securities entitled to be voted on the election of directors who has held the securities continuously for at least three years. A nominating shareholder will also be required to continue to own at least the required amount of securities through the date of the meeting at which directors are elected. Shareholders will be permitted to aggregate holdings to establish sufficient ownership and aggregating shareholders will not be required to have been a group for the entire three-year period. The nominating shareholder or group must hold both investment and voting power, either directly or through any person acting on their behalf, in order to satisfy the 3% ownership threshold. Shareholders can include shares loaned out (as long as such loaned shares may be recalled and will be so recalled upon notification that any of the nominees will be included in the company's proxy materials), but must exclude shares where only a right to acquire exists, shares sold short and shares that are borrowed.

Nominating shareholders or groups will be required to file a new form, Schedule 14N, to provide information relating to eligibility and nominees. The Amendments require a nominating shareholder or member of a nominating shareholder group to demonstrate ownership in one of several ways. If the nominating shareholder or member of the nominating shareholder group is the registered holder of the shares, he or she could so state. Where the nominating shareholder or member of the nominating shareholder group is not the registered holder of the securities, such individual would be required to demonstrate ownership by attaching to the Schedule 14N a written statement from the "record" holder of the nominating shareholder's shares (usually a broker or bank) verifying that, within seven calendar days prior to filing the notice on Schedule 14N, the nominating shareholder or member of the nominating shareholder group continuously held the securities being used to satisfy the applicable ownership threshold for a period of at least three years. In the alternative, if the nominating shareholder or member of the nominating shareholder group has filed a Schedule 13D, Schedule 13G, Form 3, Form 4, and/or Form 5, or amendments to those documents, the shareholder or group member may so state and attach a copy or incorporate that filing or amendment by reference into the Schedule 14N.

Shareholders will not be eligible to use the rule if they are holding the securities for the purpose of changing control of the company, or to gain a number of seats on the board of directors that exceeds the number of nominees a company could be required to include under new Rule 14a-11. Shareholders that had previously filed a Schedule 13D indicating an intent to effectuate a change in control would presumably be ineligible to submit a nomination.

If multiple shareholders or shareholder groups submit nominations and the number of nominees included in the submitted nominations exceeds the maximum number required to be included by the Amendments, the nominating

shareholder or group with the highest percentage of the company's voting power will have its nominees included in the company's proxy materials.

### **Nominee Qualifications**

Any person may be nominated under the Amendments so long as such person's candidacy or, if elected, board membership would not violate controlling state, federal or foreign law, or the applicable standards of a national securities exchange or national securities association, other than rules concerning director independence that rely on a subjective determination by the board. The nominee must, however, satisfy objective independence standards of the applicable national securities exchange or national securities association. Neither the nominating shareholder nor the nominee may have a direct or indirect agreement with the company regarding the nomination of the nominee prior to filing notice of the nomination on Schedule 14N. Any failed negotiations between the nominating shareholder and the company regarding a nominee will not be considered "agreements" for this purpose. There are no restrictions on the relationship between the nominating shareholder and the nominee.

### **Number of Permitted Shareholder Nominees**

A qualifying shareholder or group will be permitted the greater of one nominee or a number of nominees equal to no more than 25% of the board's total membership. So, for a board comprised of eight directors, the Amendments will permit shareholders to nominate up to two directors. For a board of thirteen, fourteen, or fifteen members, shareholders will be permitted to nominate up to three directors.

Shareholder nominees that a company otherwise would have been required to include in its proxy materials will be counted toward the 25% threshold if the company agrees to include them as company nominees after the filing of a Schedule 14N. If an incumbent board includes any director elected under Rule 14a-11 procedures whose term of office extends beyond the annual meeting date, as with a classified board, such directors will count against the 25% threshold and the number of permitted shareholder nominees will be reduced by one for each such director. However, the SEC's commentary in the release states that the SEC thought it inappropriate to include an exception to the general method of calculating the 25% threshold in the case of a shareholder-nominated incumbent director that is re-nominated by the company. Therefore, any director elected under Rule 14a-11 procedures that is subsequently re-nominated by the company will not count towards the 25% threshold.

### **Filing Requirements – New Schedule 14N**

As mentioned above, nominating shareholders will be required to file with the SEC and submit to the company a notice on new Schedule 14N. The notice to the company and filing with the SEC must be made no earlier than 150 days, and no later than 120 days prior to the anniversary of the mailing of the prior year's proxy statement.

Schedule 14N will require disclosure of the amount and percentage of the voting power of the securities owned by the nominating shareholder or group, the length of ownership, and a statement of intent to continue to hold the securities through the date of the meeting. The shareholder or group will also be required to disclose its intent respecting continued ownership of the shares following the election. Concerning the nominee, required disclosure includes biographical and other information similar to the disclosure currently required in a contested election, and whether or not the nominee(s) satisfy the company's director qualifications, if any, as provided in the company's governing documents. Disclosure regarding the nature and extent of the relationships between the nominating shareholder or group and nominee(s) and the company or any affiliate of the company must also be included, along with any website address where the nominating shareholder or group may publish soliciting materials. The Schedule 14N will require certifications that the nominating shareholder is not seeking to change the control of the company or to gain more than minority representation on the board of directors and that the nominating shareholder and nominee(s) otherwise satisfy the applicable requirements of Rule 14a-11. The nominating shareholder or each member of the nominating group will

also have to certify that the information provided is true, correct and complete to such person's knowledge and belief, after reasonable inquiry. The Amendments also permit a nominating shareholder to include in the Schedule 14N a statement of support, not to exceed 500 words, for its nominee.

### **Eligibility Determinations**

If a company accepts a shareholder nominee, it must notify the nominating shareholder or group in writing not later than 30 calendar days before filing its definitive proxy materials. If, instead, the company believes that the nominee may be excluded, then it must provide the nominating shareholder or group with notice of its intent to exclude no later than 14 calendar days after the close of the window period for submission of nominations pursuant to Rule 14a-11. Such notice is required to state the basis for the exclusion. The nominating shareholder or group will be permitted a further 14 calendar days to cure any eligibility or other deficiencies, but will not be permitted to include any substitution of a new nominee or nominating shareholder as a means to correct a deficiency identified in the company's notice of intention to exclude. If then the company continues to believe that the nomination is invalid, it will be required to provide notice to the SEC and the nominating shareholder or group no later than 80 calendar days before the company files its definitive proxy statement. After a 14-calendar day opportunity for the nominating shareholder or group to respond, the SEC staff will, in its discretion, issue a no-action response stating its views whether the exclusion would be proper. Promptly following receipt of the staff's response, the company must provide notice to the nominating shareholder or group stating whether it will include or exclude the nominee. This procedure closely resembles the methods currently used for shareholder proposals.

### **Proxy Card**

Where a shareholder nominee is included pursuant to new Rule 14a-11, the option of voting for or withholding authority to vote for the company nominees as a group, which is otherwise permitted with respect to director elections, will be forbidden. The company will be permitted to identify on the form of proxy any shareholder nominees as such and to recommend whether shareholders vote for or against or withhold votes on those nominees and management's nominees.

### **Proxy Materials**

If a shareholder nominee satisfies the rules' eligibility criteria, then the company's proxy statement must include certain information on the nominee provided on the Schedule 14N notice, including business experience and, if provided by the nominating shareholder, a statement in support of the nominee, not to exceed 500 words. The company also would have the option to include a statement of support for the management nominees.

### **Solicitations by the Nominating Shareholder or Group**

The Amendments exempt limited communications from certain disclosure, filing and other requirements of the proxy rules under two circumstances. Solicitations, including both written and oral communications, made in connection with the formation of a nominating shareholder group will be exempt under new Rule 14a-2(b)(7), subject to certain limitations. Notice of any solicitation made pursuant to the exemption must be filed on Schedule 14N, and any written soliciting materials must be included in such filing.

Rule 14a-2(b)(8) similarly will exempt solicitations in support of a shareholder nominee, subject to filing requirements, certain required disclosures, and a stricture against seeking to obtain or to act as a proxy for other shareholders.

Nominating shareholders may rely on the exemption in Rule 14a-2(b)(8) after receiving notice from the company that the company will include the nominating shareholder's nominee(s) in its proxy materials.

The Rule 14a-2(b)(7) and Rule 14a-2(b)(8) exemptions described above will not apply to solicitations made when seeking to have a nominee included in the company's proxy materials other than pursuant to Rule 14a-11 (e.g., pursuant to a procedure specified in the company's governing documents or pursuant to applicable state law provisions).

### **Application of Liability Provisions in the Federal Securities Laws**

The SEC amended Rule 14a-9 to forbid expressly any misleading misstatements or omissions by nominating shareholders. Therefore, the nominating shareholder or group will be liable for any false or misleading statements it makes about the nomination, regardless of whether the statements are ultimately included in the company's proxy materials. A company will not be responsible for information provided by the shareholder and then reproduced in the company's proxy materials. Generally, information provided by shareholders will not be incorporated by reference into company filings unless the company chooses to do so.

### **Collateral Consequences**

The SEC cautions that nominating shareholder groups will need to consider whether they have formed a group under Rule 13d-5 that would be required to file beneficial ownership reports. However, the Amendments do change the beneficial ownership reporting rules so that shareholders relying on Rule 14a-11 will not become ineligible to file a Schedule 13G in lieu of filing a Schedule 13D solely as a result of activities in connection with inclusion of a nominee under Rule 14a-11.

The Amendments will not exclude a nominating shareholder group from aggregation under Section 16. Therefore, Rule 14a-11 shareholder groups should be analyzed in the same way as any other group for purposes of determining whether group members are 10% owners subject to Section 16. The Amendments do not contain standards regarding application of the "deputized director" doctrine, which will be left to existing case law and courts.

### **Shareholder Proposals**

The Amendments also change Rule 14a-8(i)(8), governing shareholder proposals, to allow resolutions calling for amendments to a company's governing documents to alter nominating procedures. Such resolutions previously could have been excluded under the provision of the rule forbidding measures relating to an election. As an apparent consequence, few such proposals have been made in the past. As adopted, proposals by qualifying shareholders that seek to establish a procedure in the company's governing documents for the inclusion of shareholder director nominees in company proxy materials would no longer be excludable under Rule 14a-8(i)(8).

The changes to 14a-8(i)(8) also codify certain staff interpretations to prevent use of the Amendments to allow shareholder proposals related to specific elections. The codifications will explicitly disallow shareholder proposals disqualifying nominees or removing sitting directors, questioning the qualifications or character of a particular director or nominee, nominating a specific candidate otherwise than as authorized by law, or otherwise affecting the upcoming election of directors.

### **Effectiveness**

Generally, the Amendments will be effective 60 days after publication in the Federal Register. However, smaller reporting companies will not be subject to new Rule 14a-11 until after a three-year phase in period.

For Rule 14a-11, shareholders must submit their nominees no earlier than 150 days, and no later than 120 days before the anniversary date of the mailing of the company's proxy statement in the prior year. Shareholders will be able to submit nominees for inclusion in next year's proxy statement if the window period for submitting nominees for a particular company is open after the effective date of the rules. If the window period opens before, but closes after,

the effective date of the Amendments, shareholders would be able to submit nominees between the effective date of the Amendments and the close of the window period.

For Rule 14a-8, shareholders still must submit their proposals no later than 120 days before the anniversary date of the mailing of the company's proxy statement in the prior year. Shareholders will be able to submit nominees for inclusion in next year's proxy statement if the 120 day deadline falls on or after the effective date of the Amendments.

As an example, if the rules become effective on November 1, 2010, new Rule 14a-11 and amended Rule 14a-8 would be available at companies that mailed their proxy statement for their last annual meeting on or after March 1, 2010.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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