

# Corporate and Securities Update

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## SEC Adopts Shareholder Access Rules Revisions To Proxy Rules Facilitate Shareholder Nominations Of Directors

### Summary

On August 25, 2010, the Securities and Exchange Commission (the "SEC") adopted rules that expanded the rights of shareholders with respect to the nomination and election of directors to serve on the boards of directors of public companies (the "proxy access rules").<sup>1</sup> The SEC action adds new Rule 14a-11 to the SEC's proxy rules which requires, in certain circumstances, that a company include nominees for director proposed by a shareholder or a shareholder group in its proxy materials sent to shareholders in connection with an annual (or a special meeting in lieu of an annual) meeting at which directors are elected, or a written consent in lieu of such meeting. The availability of the new rule is conditioned on the nominating shareholder or group meeting certain eligibility requirements, including beneficial ownership of at least 3% of the voting power of the company's securities entitled to vote at an election of directors and holding such shares for at least three years. The new rule sets limits on the number of nominees a shareholder or group may propose to include in the company's proxy statement at the greater of one, or the number that represents up to 25% of the board of directors. In addition, the SEC amended Rule 14a-8(i)(8) to restrict, in certain circumstances, a company's ability to exclude from its proxy materials shareholder proposals to amend, or request an amendment to, the company's governing documents relating to its nomination procedures or nomination disclosure provisions.

The proxy access rules were adopted pursuant to the authority given to the SEC in the Dodd-Frank Wall Street Reform and Consumer Protection Act adopted by Congress in July 2010. The SEC has considered a variety of proxy access proposals over the years but chose to take this action now in light of the economic crisis which the SEC believes has led to concerns about the accountability and responsiveness of companies and their boards to the interests of shareholders. The amendments are designed to enable shareholders to hold boards more accountable for their decisions and to influence matters of corporate policy through the nomination and election of directors.

The effective date of the proxy access rules is 60 days after the date of publication of the rules in the Federal Register. However, compliance with new rules by companies that qualify as "smaller reporting companies"<sup>2</sup> as of the effective date of the proxy access rules will be delayed for three years after the effective date.

### Shareholder Access to Proxy Materials for the Nomination of Directors

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

Rule 14a-11 permits a shareholder, or group of shareholders, that meets the requirements of the rule to include its nominee or nominees for director in a company's proxy materials, provided that such action is not prohibited by state law or the company's governing documents.

1. See *Facilitating Shareholder Director Nominations*, SEC Release No. 33-9136 (Aug. 25, 2010) (<http://www.sec.gov/rules/final/2010/33-9136.pdf>).

2. Generally, a "smaller reporting company" is a company with a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter.

Rule 14a-11 applies to all companies that are subject to the proxy rules under the Securities Exchange Act of 1934 (the “Exchange Act”), including investment companies. However, Rule 14a-11 does not apply to companies that have only debt securities registered under the Exchange Act as well as companies that are filing Exchange Act reports on a “voluntary” basis, for example, to comply with a covenant contained in an indenture relating to outstanding debt securities.

Generally, Rule 14a-11 does not apply to foreign private issuers. However, in the case of a non-U.S. domiciled issuer that does not meet the definition of a foreign private issuer under the federal securities laws, Rule 14a-11 will apply if applicable foreign law does not prohibit shareholders from nominating a candidate for election as a director. Note that if a company’s governing documents prohibit shareholder nominations, shareholders could seek to amend such provisions by submitting a shareholder proposal under Rule 14a-8. See *“Narrowing of ‘Election Exclusion’ under Rule 14a-8(i)(8)”* below.

## B. Shareholder Eligibility Requirements

In order to utilize the new rule, a nominating shareholder or group is required to own at least 3% of the voting power of the company’s securities entitled to vote at the meeting. Shareholders may aggregate their shares to meet this threshold.

In addition, the nominating shareholder or group is required to have held this required amount of voting securities continuously for at least three years prior to its or their notice to the company of the intent to submit a nominee or nominees for inclusion in the company’s proxy materials.

The nominating shareholder or group must hold both investment and voting power, either directly or through any person acting on their behalf, of the securities. In calculating the ownership percentage, under certain circumstances, securities loaned to a third party may be included. On the other hand, securities that the shareholder or group has the right to acquire (for example, common stock underlying unexercised options) and securities sold short (as well as securities borrowed that are not otherwise excludable) must be deducted from the number of securities that may be counted towards the required ownership threshold.

## C. Shareholder Statements and Representations

In addition to imposing certain eligibility requirements on the nominating shareholder or shareholders, the rule requires such shareholders make certain statements and representations on a new Schedule 14N related to their share ownership and intentions with respect to the nomination of directors, including:

- that the shareholder’s intent is to continue to hold its

qualifying amount of voting securities through the date of the meeting for the election of directors;

- disclosure of the shareholder’s intent with regard to continued ownership of the securities after the election of directors;
- that the shareholder is not seeking to change the control of the company or to gain more than the number of seats on the board that the company could be required to include under the rule; and
- neither the nominating shareholder nor its nominee or nominees has an agreement with the company regarding the nomination of the nominee.

## D. Limit on Number of Nominees

In order to prevent shareholders from using the rule as a means to effect a change of control of the company, the new rule limits the number of shareholder nominees a company is required to include in the proxy materials to the greater of one, or the number of nominees that represents up to 25% of the board of directors. In calculating 25% of the board of directors, incumbent directors who were previously elected as shareholder nominees under the rule are counted as part of the board of directors. When a company has classified board, the 25% calculation is still based on the total number of board seats. To address situations where more than one eligible shareholder or group of shareholders submits a nomination, the rule provides that the nominating shareholder or group with the highest percentage of the company’s voting power would have its nominees included in the company’s proxy materials rather than priority being given to the shareholder from whom the company first receives timely notice of intent to nominate a director.

## E. Timing of Nominations and Shareholder Nominee Requirements

A nominating shareholder or group must inform the company of its intent to require the company to include its nominee or nominees in the company’s proxy materials by providing a Schedule 14N to the company and filing it with the SEC no earlier than 150 days and no later than 120 calendar days prior to the anniversary of the date the company mailed its proxy materials to shareholders for the previous year’s annual meeting.

The nominating shareholder must also make a representation in its Schedule 14N that:

- neither the nominee’s candidacy nor, if elected, such nominee’s service on the board will violate state or federal law or the applicable listing standards (excluding standards relating to director independence); and
- its nominee meets the objective criteria for independence of the applicable rules of a national securities

exchange or, in the case of a registered investment company, such nominee is not an “interested person” of the company as defined in the Investment Company Act of 1940.

The new rule also requires that the nominating shareholder or group make or include other statements and disclosures in its Schedule 14N, including, among other things:

- a statement that the nominee consents to be named in the proxy statement and form of proxy and, if elected, to serve on the board;
- the name and address of the nominating shareholder or each member of the nominating shareholder group;
- the amount and percentage of securities held and entitled to vote on the election of directors at the meeting and the voting power derived from securities that have been loaned or sold in a short sale that remains open;
- whether the nominating shareholder or any member of a nominating shareholder group has been involved in any legal proceeding during the past ten years, as specified in Item 401(f) of Regulation S-K;
- whether, to the best of the nominating shareholder’s or group’s knowledge, the nominee meets the director qualifications set forth in the company’s governing documents, if any;
- the nature and extent of the relationships between the nominating shareholder(s) and the nominee and/or the company or any affiliate of the company, including involvement in material pending or threatened litigation, transactions with the company, and any other material relationship between the nominating shareholder(s) or the nominee and/or the company or any of its affiliates; and
- any website on which the nominating shareholder or group may publish soliciting materials.

In addition, under the rule, the nominating shareholder is permitted to include a statement in support of its nominee(s), not to exceed 500 words, for inclusion in the company’s proxy statement. There is no restriction on relationships between the nominee and the nominating shareholder or group.

However, a company is not required to include in its proxy materials information regarding any nominee whose candidacy or, if elected, board membership would violate controlling state or federal law, or the applicable standards of a national securities exchange, except with regard to director independence requirements that rely on a subjective determination by the board, and such violation could not be cured during the provided time period. A company is also not required to include in its proxy materials information regarding any nominee whose candidacy or, if elected, board membership would violate controlling foreign law.

## F. Notice of Inclusion or Exclusion of Nominee

A company may determine it is not required to include a nominee from a nominating shareholder or group in its proxy materials under the new rule if:

- the nominating shareholder or group has not complied with the requirements of the new rule;
- the nominee does not meet the requirements of the new rule;
- a representation required to be included in the notice to the company is false or misleading in any material respect; or
- the company has received more nominees than it is required to include under the rule.

Under the new rule, a company that determines to include a nominee in its proxy materials is required to notify the nominating shareholder or shareholders of such determination and the notice must be postmarked or transmitted electronically no later than 30 calendar days prior to the filing of its definitive proxy statement with the SEC. Although it is not required, it is in a company’s best interest to send the notice to the nominating shareholder or group in a manner that will allow the company to demonstrate that the nominating shareholder or group received the notice.

In the event a company determines that it is not required to include a shareholder nominee in its proxy materials, notice of such fact must be postmarked or transmitted electronically to the nominating shareholder or shareholders within 14 calendar days after the receipt of the company’s notice of the receipt of such shareholder or shareholders’ notice of intent and include an explanation of the company’s basis for such exclusion. The nominating shareholder or group has 14 calendar days after the receipt of the company’s notice to respond to the company’s notice and correct any eligibility or procedural deficiencies identified in such notice. Under the rule, upon receipt of the nominating shareholder’s or group’s response, if the company determines that it may still exclude such shareholder(s) nominee or nominees, the company would be required to provide notice of the basis of its determination to the SEC and the nominating shareholder or group no later than 80 calendar days before the company files its definitive proxy statement. The company’s notice to the SEC must include:

- the identification of the nominating shareholder or each member of the nominating shareholder group, as applicable;
- the name of the nominee or nominees;
- an explanation of the company’s basis for excluding a nominee or nominees; and
- a supporting opinion of counsel when the company’s basis for excluding a nominee or nominees relies on matters of state law.

The nominating shareholder may submit a response to the company's notice to the SEC within 14 calendar days of the receipt of the company's notice to the SEC. The SEC, at its discretion and upon request of the company, may provide a no-action letter to the company and the nominating shareholder reflecting the SEC's informal views of the company's determination. The SEC, however, will not adjudicate the merits of a company's position with respect to such determination to exclude a shareholder nominee.

### Narrowing of "Election Exclusion" under Rule 14a-8(i)(8)

The amended Rule 14a-8 substantially narrows the scope of the election exclusion by prohibiting a company from excluding from its proxy materials shareholder proposals that would amend, or that request an amendment to, the company's governing documents concerning nomination procedures or disclosures related to nominations by shareholders. Under current Exchange Act Rule 14a-8(i)(8), or the so-called "election exclusion", a company is permitted to exclude from its proxy statement a shareholder proposal that relates either to a nomination or an election for membership on the board of directors or a procedure for such nomination or election. In order for the shareholder proposal to qualify for inclusion, such proposal should not conflict with either state law or Rule 14a-11. Furthermore, the shareholder proposal is required to meet the existing procedural requirements of Rule 14a-8, including the requirement that such shareholder have continuously held for at least one year at least \$2,000 in market value, or 1%, of the company's voting securities entitled to vote on such proposal, and not be

subject to one of the other substantive exclusions under Rule 14a-8.

In addition, to maintain a company's right, under certain circumstances, to exclude from its proxy materials shareholder proposals relating to particular elections and nominations for director and to codify certain SEC interpretations, the rule does not prohibit a company from excluding a proposal under Rule 14a-8(i)(8) if such proposal:

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

### New Form 8-K Disclosure

If a company did not hold an annual meeting during the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, within 4 business days of determining the anticipated meeting date a company is required to file a Form 8-K to disclose the date by which a nominating shareholder or group must submit notice on Schedule 14N to include a nominee in the company's proxy materials. This date would be a reasonable time before the company mails its proxy materials for the meeting. ■

### Questions

Any person who has a question regarding the issues raised in this *Corporate and Securities Update* may obtain additional guidance from a member of our Public Companies Group ([www.blankrome.com](http://www.blankrome.com)).

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