

Legal Alert

September 2010

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Proxy Access Rule For Shareholder Director Nominations

On August 25, 2010, the Securities and Exchange Commission (SEC) voted 3 to 2 to adopt amendments (Amendments) to the federal proxy rules that will implement a new system of “proxy access,” which has come to mean a procedure by which shareholders of a public company can participate in the director nomination process. Under the Amendments, a shareholder or group of shareholders meeting eligibility requirements can require a public company to include a limited number of director nominees proposed by the shareholder in management’s proxy materials.

In her introductory remarks opening the SEC’s August 25 open meeting, SEC Chairman Mary L. Schapiro noted that proxy access has been debated for more than 30 years. She noted, too, that some past debate concerned whether the SEC has the authority to adopt proxy access rules. That issue was resolved in July 2010 with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which gave the SEC explicit authority to make rules addressing shareholder access to company proxy materials. The proxy access rules, which are primarily contained in new Rule 14a-11 promulgated under the Securities Exchange Act of 1934 (Exchange Act), permit a single shareholder or group of shareholders owning at least 3 percent of the voting power of shares entitled to vote for directors to nominate a number of directors up to 25 percent of the total number of directors that comprise the board and to have such nominees included in the company’s proxy statement. The rules are intended to be effective for the 2011 proxy season, going into effect 60 days after they are published in the Federal Register.

The adopting release, which includes the text of the Amendments and new Schedule 14N that must be filed by a nominating shareholder or shareholder group during the nomination window period, is available at the SEC website. The most significant provisions of the Amendments are discussed below.

Affected Companies

New Rule 14a-11 will apply to companies that are subject to Exchange Act proxy rules, including registered investment companies. There is no exception for controlled companies, and the rule will also apply to companies that elect to voluntarily register a class of equity securities under Section 12(g). Smaller reporting companies (public companies with less than US\$75 million in common equity public float) will be subject to Rule 14a-11, but on a delayed basis beginning on the third anniversary of the effective date of the rule.

Rule 14a-11 will not apply to companies that are subject to the SEC's proxy rules solely because the company has a class of debt registered under Section 12 of the Exchange Act. Foreign private issuers, which are exempt from the SEC's proxy rules with respect to solicitations of their shareholders, will be exempt from Rule 14a-11. Rule 14a-11 is mandatory for all subject companies, and there is no "opt-in" or "opt-out" provision in the new rules. Even with the approval of its shareholders, a company may not increase the ownership threshold for proxy access. A company may adopt proxy access rules that are more permissive of proxy access than Rule 14a-11, but may not adopt rules that restrict the operation of Rule 14a-11.

Shareholder Eligibility

Rule 14a-11 will require companies to include in their proxy materials director nominees proposed by any owner of at least 3 percent of the total voting power of the company's securities entitled to be voted in the election of directors who has held the securities continuously for at least three years. The three year holding period is measured from the date the nominating shareholder or group files its Schedule 14N with the SEC announcing its submission of a director nominee or nominees. A nominating shareholder will be required to continue to own at least the required amount of securities at least through the date of the meeting at which directors are elected. Shareholders may aggregate holdings to establish sufficient ownership. The nominating shareholder or group must hold both voting and investment power, either directly or through any person acting on their behalf, in order to satisfy the 3 percent ownership and three continuous year holding thresholds. Shareholders may include shares loaned out (as long as loaned shares may be recalled and will be recalled upon notification that any of the nominees will be included in the company's proxy materials). A shareholder may not include shares sold short, shares that are borrowed or shares where only the right to acquire exists (e.g., shares subject to an exercisable option are not includable in any calculation to determine whether the 3 percent threshold has been met).

Nominating shareholders or groups will be required to file a new form, Schedule 14N, to provide information relating to eligibility and nominees. The new rules require a nominating shareholder or members of a group of nominating shareholders to demonstrate ownership of shares in any of several ways. If the nominating shareholder or group member is the registered holder of the shares, the holder should so state; if he or she is not the registered owner, he or she must demonstrate ownership by attaching to Schedule 14N a written statement from the "record" holder of the nominating shareholder's shares verifying that, within seven days before filing the Schedule 14N, the nominating shareholder or member of the nominating shareholder group continuously held the securities being used to satisfy the applicable ownership threshold of at least three years. In the alternative, if the nominating shareholder or member of the group has filed a Schedule 13D, Schedule 13G, Form 3, Form 4 or Form 5, or amendments to these documents, that shareholder or group member may so state and attach a copy or incorporate the filing or amendment into the Schedule 14N.

Shareholders will not be eligible to use Rule 14a-11 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 Rule 14a-11. If a shareholder has previously filed a Schedule 13D that indicated intent to effectuate a change of control, that shareholder would presumably be ineligible to submit a nomination under Rule 14a-11.

If multiple shareholders or groups submit nominations and the number of nominees surpasses the maximum number required to be included by Rule 14a-11, the nominating shareholder or group of nominating shareholders with the highest percentage of the company's voting power will have its nominee or nominees included in the company's proxy materials.

How Many Shareholder Nominees Must Be Included?

A qualifying shareholder or group may nominate the greater of one nominee and a number of nominees equal to no more than 25 percent of the board's total membership. This is the case regardless of whether the board is classified. Thus, if a shareholder were entitled to nominate three directors and only three members of a classified board were being elected that year, the shareholder would be entitled to nominate persons to fill the entire class. If 25 percent of the number of authorized directors is not a whole number, the number of nominees that must be included is rounded down to the nearest whole number. For a board of eight members, shareholders will be permitted to nominate up to two directors. For a board of 13, 14 or 15 members, shareholders will be permitted to nominate up to three directors.