Securities Law Alert: SEC Votes to Expand Proxy Access Rights of Shareholders

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The Securities and Exchange Commission (SEC or the "Commission") has voted to propose changes to the rules governing proxy access by shareholders of public companies in order to facilitate director nominations by shareholders using companies' own proxy statements.

The Commission, at its open meeting held on May 20, 2009, voted in a 3-2 decision to propose these rules for a 60-day public comment period. Given the strong opinions held by both sides of the debate over proxy access, many of which were expressed by the Commissioners themselves at the open meeting, comments are expected to be extensive. Nonetheless, the rules could be effective in time for the 2010 proxy season.

SEC Chairman Mary Schapiro noted the Commission's belief that these rules are necessary in order to respond to the public's increasing demands, in light of recent stock market disruptions, for greater accountability and responsiveness on the part of boards of directors of public companies. She also noted the belief that enhanced access to company proxy statements is necessary in order to ensure that shareholders have a meaningful opportunity to influence the composition of the boards of directors of the companies of which they are owners.

Opponents of the proposed rules note that they appear to represent an intrusion by a federal government agency into the substance of the corporate governance process, an area that historically has been left in the hands of state corporate law. As an example, the Sarbanes-Oxley Act of 2002 largely imposed disclosure requirements on companies and their boards of directors, as opposed to mandating specific governance practices, which were left either to state corporate laws or the listing requirements of self-regulatory organizations, such as the national securities exchanges.

While the text of the proposed rules is not yet publicly available, below is a summary of the proposed rules. The proposals address two primary areas:

- inclusion of shareholder nominees in company proxy statements; and
- shareholder proposals to modify company nomination procedures.

Inclusion of Shareholder Nominees in Company Proxy Statements

The proposed rules would create new Rule 14a-11 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), allowing shareholders to include nominees for director positions

in the company's own proxy materials, unless the shareholders are prohibited by state law or a company's charter or bylaws from nominating a candidate for election as a director.

The right to include nominees would be based on tiered ownership thresholds, depending on the size of the company, as follows:

- For **large accelerated filers** (companies with worldwide public float values of $700 million or more) or registered investment companies with net assets of $700 million or more: shareholders would have to have owned at least 1 percent of the voting securities for at least one year.
- For **accelerated filers** (companies with worldwide public float values of $75 million or more but less than $700 million) or registered investment companies with net assets of $75 million or more but less than $700 million: shareholders would have to have owned at least 3 percent of the voting securities for at least one year.
- For **non-accelerated filers** (companies with worldwide public float values of less than $75 million) or registered investment companies with net assets of less than $75 million: shareholders would have to have owned at least 5 percent of the voting securities for at least one year.

Shareholders would be able to aggregate their holdings together in order to satisfy the ownership thresholds set forth above, and they would not lose eligibility to report their holdings on Schedule 13G solely as a result of making a nomination under this new rule. Nominating shareholders would be required to (1) certify that they are not holding their stock for the purpose of changing control of the company, or to gain more than a minority representation on the board of directors, and (2) declare their intent to continue to own their shares through the annual meeting at which directors are to be elected.

Nominees would be required to be independent of the company, as defined by the independence standards of the national securities exchange or national securities association on which the company's securities are traded. However, nominees would not be required to be independent of the nominating shareholder. This represents a change from previously proposed, but never adopted, proxy access rules.

Proposed Rule 14a-11 would provide a limit on the number of nominees that could be proposed by a shareholder of (1) one nominee or (2) up to 25 percent of the company's board of directors, whichever is *greater*. Using the Commission's examples, if the board is comprised of three members, one shareholder nominee could be included in the company's proxy materials. If the board is comprised of eight members, up to two shareholder nominees could be included in the proxy materials.

In order to nominate a director, the nominating shareholder would submit a new filing, to be known as a *Schedule 14N,* to the Commission and to the issuer, including the following information:

- disclosure of the amount and percentage of the company's securities owned by the nominating shareholder;
- the length of ownership of those securities;

- a statement as to the shareholder's intent to continue to hold the securities through the date of the meeting; and
- a certification that the nominating shareholder is not seeking to change the control of the company or to gain more than a minority representation on the board of directors.

The *Schedule 14N* would have to be filed at least 120 days prior to the first anniversary of the date on which the proxy materials for the company's annual meeting held during the previous year were publicly released. The company would then be required to include disclosure concerning the nominating shareholder, as well as the shareholder nominee or nominees, in its proxy materials, that is similar to the disclosure currently required in a contested election.

During the open meeting, the Staff of the Commission alluded to procedures that would be established for companies to challenge the validity of submissions, in a manner similar to that currently used for the challenging of other shareholder proposals pursuant to Rule 14a-8 under the Exchange Act. However, the details of those procedures are not yet available.

Shareholder Proposals to Modify Company Nomination Procedures

The proposed rules would also amend Exchange Act Rule 14a-8(i)(8) in order to provide that shareholders could require companies, under certain circumstances, to include proposals in their proxy materials that would require or request amendments to company charters and bylaws addressing nomination procedures. Under this amended rule, for example, shareholders could propose resolutions to require a company to amend its bylaws in order to specify particular procedures by which shareholders can propose director nominees. Exchange Act Rule 14a-8(i)(8) currently allows exclusion of shareholder proposals that "relate to an election." The proposed changes to Rule 14a-8(i)(8) would narrow this exclusion.

In order to submit a proposal under this amended rule, a shareholder proponent would be required to have continuously held at least $2,000 in market value (or 1 percent, whichever is less) of the company's securities entitled to be voted on the proposal at the meeting, for a period of one year prior to submitting the proposal. These are the same eligibility provisions as those currently set forth under Rule 14a-8.

Recent Changes in Delaware Law

These proposals from the Commission come in the wake of recent changes to the Delaware General Corporation Law (DGCL), signed into law in April 2009, adding new Sections 112 and 113 to the DGCL. These sections allow, but do not require, companies to include provisions in their bylaws relating to proxy access by shareholders.

New Section 112 of the DGCL allows, but does not require, companies to include provisions in their bylaws that specifically provide for access by shareholders to the company's proxy materials with regard to director nominations. The provisions may include conditions to the

access right, such as eligibility and procedural requirements, including ownership levels, background information about the nominee, and any other conditions permitted by law. New Section 113 of the DGCL similarly allows, but does not require, companies to provide in their bylaws for the reimbursement by a company of expenses incurred by a shareholder in nominating director candidates. The reimbursement provision may include conditions, such as the number or proportion of nominees proposed and whether the shareholder has requested reimbursement previously.

Many Delaware companies already have such provisions in their bylaws. However, in light of the Commission's proposed revisions to Rule 14a-8(i)(8) described above, activist shareholders will now have a specific statutory roadmap to follow when proposing changes to Delaware companies' bylaws for companies that do not already have such provisions.

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It remains to be seen what form the final proxy access rules to be adopted by the Commission will take. However, it seems clear that in the words of Commissioner Elisse Walter (quoting Victor Hugo) at the open meeting, the Commission believes that easier proxy access is an idea whose time has come, and the question now is not whether, but when, easier proxy access will become a reality.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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