

Akerman Practice Update

CORPORATE

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SEC Adopts Proxy Access; Effective Beginning 2011 Proxy Season

On August 25, 2010, the Securities and Exchange Commission (the “SEC”) adopted, by a three-to-two vote, new proxy access rules. Under newly adopted Rule 14a-11 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), shareholders or groups holding at least 3% of the voting power of a public company’s securities, and who have held their shares for at least three years, have the right to include director nominees in company proxy materials. In addition, the SEC voted to amend existing Rule 14a-8 under the Exchange Act to provide that companies may not exclude from their proxy materials shareholder proposals that seek to establish less restrictive proxy access procedures and adopted a number of related rule amendments intended to facilitate proxy access.

The new rules apply to all companies that have a class of equity securities and are subject to the SEC’s proxy rules, including investment companies and controlled companies. The new rules do not apply to foreign private issuers. The new rules provide for a three-year delay in effectiveness for “smaller reporting companies,” or companies that have a public float of less than \$75 million.

The new rules will become effective 60 days after their publication in the Federal Register, and proxy access will apply for a company’s 2011 annual meeting if the first anniversary of the mailing of the 2010 proxy materials occurs within 120 days of effectiveness. For example, if the new rules become effective on November 1, 2010, proxy access would apply to companies that mailed their 2010 annual meeting proxy statement no earlier than March 1, 2010.

The full text of the final rules is available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>. This practice update highlights the key provisions of the new rules.



Background

The SEC proposed the proxy access rules in June 2009 and, as a result, received hundreds of comments from companies, shareholders, law firms, academics, and other interested parties. A notable suggestion during the comment period was to permit shareholders to limit the applicability of proxy access to suit the individual circumstances of a company or even to opt-out entirely. In adopting the final rules, the SEC rejected any ability of companies to opt-out, and the final rules only permit modifications that expand proxy access beyond what is required by the new rules.

Rule 14a-11

New Rule 14a-11 gives shareholders and shareholder groups the right to have nominees for director included on the company's proxy card and ballot and described in its proxy statement. Key elements of the rule include:

Eligibility of Nominating Shareholder or Shareholder Group

- The nominating shareholder or shareholder group must collectively own at least 3% of the voting power of a company's securities (as opposed to the 1%, 3%, or 5% tiered approach based on company size originally proposed). Group members are permitted to aggregate their shares to reach this ownership threshold.
- The nominating shareholder or shareholder group must have held the requisite number of securities continuously for at least three years (as opposed to the one-year period originally proposed). The nominating shareholder or shareholder group must continue to hold the requisite number of securities through the meeting and must disclose its intent with respect to continued ownership after the meeting.
- The nominating shareholder or shareholder group must have both the power to dispose of and the power to vote the securities. A shareholder may not borrow shares or include shares sold short in order to meet the requisite ownership level but may count shares loaned to third parties if the shareholder has the right to recall the loaned shares and will do so if its nominee is included in the company's proxy materials.

Maximum Number of Nominees/Eligibility of Nominees

- The number of shareholder nominees may be up to a maximum of 25% of the entire board (or one director, whichever is greater), even if the company has a classified board with only one-third of the board up for election at that meeting (but shareholder nominees serving a three-year term will count against the 25% cap for the following two annual meetings).

- A nominating shareholder or shareholder group must certify that it is not seeking to change control of the company or to gain a number of seats on the board of directors representing more than the maximum permitted under the rule.
- The nominee of a nominating shareholder or shareholder group must meet the objective independence standards of the stock exchange on which the company's securities are listed. The nominee will not be required to meet director qualification standards included in the company's governing documents. The nomination or board membership of the nominee must not violate applicable laws or regulations.
- There are no restrictions on relationships between the nominating shareholder or shareholder group and the nominee.
- Neither the nominating shareholder or shareholder group nor the nominee may have a direct or indirect agreement with the company regarding the nomination of the nominee at the time of filing the Schedule 14N.
- If nominations from all eligible nominating shareholders or shareholder groups exceed the maximum number of permitted nominees, priority is to be given to the candidates nominated by the largest nominating shareholder or shareholder group (as opposed to the "first in" mechanism originally proposed).

Nominating Process; Schedule 14N

- A nominating shareholder or shareholder group must file with the SEC a Schedule 14N that sets forth specified information about the nominating shareholder or shareholder group and the nominee. A nominating shareholder or shareholder group must disclose in the Schedule 14N its ownership and voting interest in the company and length of ownership, its eligibility to use Rule 14a-11, the nature and extent of any relationships between the nominating shareholder, its nominees and/or the company, its involvement in legal proceedings, whether, to the knowledge of the nominee, the nominee satisfies the qualification standards for directors as provided in the company's governing documents, and other information.
- The Schedule 14N must be filed no earlier than 150 days, and no later than 120 days, prior to the anniversary of the mailing date for the prior year's proxy materials.
- A company may challenge a nomination that it believes it is not required to include by seeking no-action relief with the SEC no later than 80 days before the definitive proxy statement is filed.
- A company will not be liable for information provided by a nominating shareholder or shareholder group included in the proxy statement.

Amendment to Rule 14a-8

In addition to adopting new Rule 14a-11, the SEC amended existing Rule 14a-8 to provide that a company may not exclude from its proxy materials shareholder proposals that seek to establish a procedure in the company's governing documents for the inclusion of shareholder director nominees in the company proxy materials.

Companies will, however, be permitted to exclude a shareholder proposal pursuant to Rule 14a-8(i)(8), however, if it:

- would disqualify a nominee who is standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, business judgment, or character of one or more nominees or directors;
- seeks to include a specific individual in the company's proxy materials for election to the board of directors; or
- otherwise could affect the outcome of the upcoming election of directors.

The SEC also adopted amendments to narrow the "election exclusion" in Rule 14a-8(i)(8) that will allow shareholders to make proposals to broaden (but not narrow) proxy access, such as a lower ownership threshold, a shorter holding period, or to allow for a greater number of nominees.

Item 5.08 to Form 8-K

In addition, the SEC added a new disclosure item to the Current Report on Form 8-K. If a company did not hold an annual meeting during the prior year, or if the date of the meeting has changed more than 30 days from the prior year, the company must disclose under Item 5.08 of Form 8-K the date by which a nominating shareholder or group must submit the notice on Schedule 14N.

Proxy Solicitation Exemptions

The SEC adopted largely as proposed two exemptions from the proxy solicitation rules applicable to nominating shareholders that are intended to facilitate proxy access. First, the rules provide an exemption from disclosure and other applicable requirements of the proxy rules for communications by any shareholder in connection with forming a nominating shareholder group provided certain conditions are met. Second, the rules provide an exemption for solicitations by a nominating shareholder or shareholder group in support of a nominee included in a company's proxy materials provided certain conditions are met.

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Section 13, Section 16 and Affiliate Status

As proposed, the SEC adopted rule amendments providing that a nominating shareholder does not lose Schedule 13G eligibility solely due to a Rule 14a-11 nomination. Also as proposed, the SEC did not provide guidance as to whether a nominating shareholder group has formed a “group” for purposes of Section 13 or Section 16 of the Exchange Act. Nominating shareholders, therefore, must continue to analyze their “group” status under existing rules and interpretations. The SEC, however, did not provide a “safe harbor” from “affiliate” status under the securities laws for a nominating shareholder as originally proposed. The SEC concluded it did not believe that the proposed safe harbor would provide a level of certainty to nominating shareholders concerning their potential “affiliate” status sufficient to warrant a departure from the current application of the term, and found it more appropriate to conduct a facts-and-circumstances analysis instead, as is currently applicable in other situations.

Action Items

Each public company should consider how the new rules will affect it for the 2011 proxy season and beyond based on its own circumstances, including its jurisdiction of incorporation, governing documents, board composition, shareholder base and relationship with its investors.

For more information, please contact a member of our Corporate practice.

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