

Akerman Practice Update

CORPORATE

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SEC Proposes Shareholder Access Rules

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The U.S. Securities and Exchange Commission (“Commission”) recently proposed an amendment to the rules under the Securities Exchange Act of 1934 (the “Exchange Act”) to require that companies, under certain circumstances, include in their proxy materials nominees for director that are nominated by a shareholder or group of shareholders. The proposed rules would also require, under certain circumstances, that companies include in their proxy materials shareholder proposals to amend a company’s governing documents regarding nomination procedures or disclosures related to shareholder nominations.

The proposal would create a new Rule 14a-11 under the Exchange Act (dealing with proxy access for shareholder nominees for director) and modify Exchange Act Rule 14a-8(i)(8) (dealing with shareholder proposals to modify the company’s nomination procedures or disclosures relating to shareholder nominations). To review the proposing release, click [here](#). The release includes a comprehensive review of the shareholder access issue and requests comment on close to 500 questions. Comments are due on or before August 17, 2009. We believe that the Commission is likely to adopt final rules so that they are in place for the 2010 proxy season.

History and Background

Shareholders do not currently have the right under the rules of the Commission to include director nominees in the company’s proxy statement, and shareholders who seek today to nominate a director to a company’s board of directors must comply with the Commission’s proxy rules and the company’s governing documents. The Commission sought to address the issue of shareholder access to the proxy statement in both 2003 and 2007. In each of the previous proposals, new rules

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would have granted to shareholders access rights or the right to propose by-law amendments that would permit shareholders to have director nominees included in the company’s proxy statement. In both cases, and in contrast to the current proposal, shareholder access to the proxy statement was proposed to be a two-stage process with a triggering or enabling act in year one (for example, if a minimum 35% withhold vote had been received with respect to a director nominated by the board of directors in the preceding year) followed by shareholder access to the company’s proxy statement in year two.

In both 2003 and 2007, there was strong criticism of the proposed rules from those who perceived that the Commission was encroaching on an area of corporate governance that was within the purview of state corporate law. In both years, the Commission chose not to adopt the proposed shareholder access proposals, although in 2007 the Commission did amend Rule 14a-8(i)(8) to permit companies to exclude from their proxy statement any shareholder proposals that would result in a contested election in the year of the proposal or in future years. In the current environment, it seems much more likely that affirmative action will be taken on the shareholder access issue, and the substance of the Commission’s rule proposal is supported by several legislative initiatives.¹

Proposed Proxy Access Rule (Proposed Rule 14a-11)

Under Proposed Rule 14a-11, companies, under certain circumstances, would be required to include shareholder nominees for director in the company’s proxy materials. The proposed rule would apply to all Exchange Act reporting companies that have a class of equity securities registered under Section 12 of the Exchange Act.² However, it would not apply to companies that are subject to the proxy rules solely because they have debt securities registered under the Exchange Act or to foreign private issuers.

Shareholders or shareholder groups eligible to nominate directors

To be eligible to nominate directors under the proposed rule, shareholders, either individually or aggregated as a group, would have to own the following minimum amount of a company’s voting securities:

- At least one percent of the voting securities if the company is a “large accelerated filer” (a company with a worldwide market value of \$700 million or more);
- At least three percent of the voting securities if the company is an “accelerated

¹ Recent changes in Delaware’s corporate statute (which become effective on August 1, 2009) will allow (but not require) Delaware corporations to adopt bylaws that would provide for shareholder access to the company proxy materials for the purpose of proposing director nominees pursuant to the procedures and conditions set forth in those bylaws. Further, on May 19, 2009 Senator Charles Schumer proposed the “Shareholder Bill of Rights Act of 2009” in the U.S. Senate. Subsequently, on June 12, 2009 Representative Gary Peters introduced a similar but more expansive bill, the “Shareholder Empowerment Act of 2009” in the U.S. House of Representatives. The new legislation, if enacted, would establish, among other things, parameters for the Commission to set rules allowing shareholder access to company proxy solicitation materials for purposes of nominating directors. In addition, these bills address many of the reforms that activist shareholders have sought over the years, including “say on pay,” annual election of all directors, majority voting in uncontested elections of directors and separation of the chairperson of the board of directors from the chief executive officer.

² The proposed rule will also apply to investment companies registered under Section 8 of the Investment Company Act of 1940.

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filer” (a company with a worldwide market value of at least \$75 million but less than \$700 million); and

- At least five percent of the voting securities if the company is a “non-accelerated filer” (a company with a worldwide market value of less than \$75 million).

Shareholders must have held their shares for at least one year prior to the date that notice is given to the company of the intent to submit nominees for inclusion in the proxy materials. Further, the shareholder must make an affirmative statement (see discussion on proposed Schedule 14N below) that it intends to own the shares through the date of the annual meeting at which directors are to be elected.

Shareholders would be permitted under the proposed rule to aggregate their holdings to meet the applicable threshold requirement, and in such a case each member of the shareholder group must satisfy the one year holding period requirement. Shareholders who join together as a group solely for the purpose of nominating a director under the proposed rule would not lose eligibility to file a Schedule 13G. However, the proposing release does not include any modification to the Section 16 reporting requirements and as a result, a group formed to nominate a director under the proposed rule would be required to file reports under Section 16 of the Exchange Act if the group owns more than 10 percent of the company’s voting securities.

The proposed rule prohibits its use by shareholders seeking to effect a change of control of the company. Further, neither the nominee nor the nominating shareholder (or any member of the nominating group) would be allowed to have an agreement with the company or an affiliate of the company regarding the nomination (to reduce the risk of a nominating shareholder or group acting as a surrogate for the company’s management to block usage of the rule by another nominating shareholder or group).

Requirements for proposed director nominees

The proposed rule puts no limits on which individuals may be nominated by shareholders for election to the board of directors, so long as: (i) the nominee’s candidacy or, if elected, board membership, does not violate applicable state or federal law or the rules of a self-regulatory organization (“SRO”), and (ii) the nominee satisfies the objective independence criteria of the applicable SRO. If the company has requirements for nominees that are more restrictive than the independence criteria applicable to directors generally, the company would not be able to exclude a nominee proposed under proposed rule 14a-11 by reason of such restrictions.

How many nominees must a company include in its proxy statement pursuant to the proposed rule

The proposed rule would require a company to include one shareholder nominee in the proxy statement or such number of nominees that represents up to 25% of the company’s board of directors (rounded down), whichever is greater. If multiple shareholders or groups of shareholders who meet the ownership requirements applicable to the company nominate more directors than are allowed under the

rules, the nominations would be accepted on a “first come, first served basis” – i.e., the earlier-submitted nominees would be placed on the ballot.

When notice would have to be given and what information would need to be disclosed

A shareholder wishing to include a nominee for director in the company’s proxy materials would be obligated to provide notice to the company by the date specified by the company’s advance notice bylaw, or, where no such bylaws are in place, no later than 120 days before the anniversary of the company’s prior annual meeting. The proposed rule also provides that if a company did not hold an annual meeting in the previous year, or if the meeting date has changed by more than thirty (30) days from the previous year, the nominating shareholder is obligated to provide reasonable notice before the company mails its proxy materials. If the company did not hold an annual meeting during the prior year or changes its meeting date by more than 30 days, the company will be obligated to report the new anticipated meeting date on Form 8-K (under newly proposed Item 5.07) within four days after the company determines the anticipated meeting date.

Shareholders who wish to nominate directors will be obligated to send to the company and file with the Commission a new Schedule 14N. Schedule 14N would require certain information regarding the shareholder or shareholder group and the nominee for the Board of Directors, including: (i) the name and address of the nominating shareholder or each member of the nominating shareholder group; (ii) information regarding the amount and percentage of securities beneficially owned and entitled to vote at the meeting by each shareholder or each member of the shareholder group; (iii) a written statement from the record stockholder or stockholders of the shares owned by the nominating shareholder or shareholder group verifying that, as of the date of the Schedule 14N, the shareholder or each member of the shareholder group had held their shares for a period of at least one year; (iv) a written statement from the shareholder or each member of the shareholder group of their intent to own the requisite shares through at least the meeting at which the directors are elected, and a written statement regarding the nominating shareholder or shareholders’ intent with respect to continued ownership of company securities after the election; and (v) a certification from the nominating shareholder or each member of the nominating shareholder group that the securities are not held for the purpose of changing control of the issuer or gaining control of the company’s board of directors.

Shareholders filing a Schedule 14N would also be required to submit additional information relating to the nominated director, relationships between the proposed director and the company and other matters.

What a company must do after receiving a Schedule 14N

A company’s first responsibility after receiving a shareholder nomination for director would be to determine the shareholder’s or the shareholder group’s eligibility to nominate a director under the proposed rule. If the company determines that the shareholder

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or shareholder group is eligible to nominate a director, they must notify in writing the shareholder or shareholder group no less than 30 days before the company’s definitive proxy statement and form of proxy are to be filed with the Commission.

If a company determines that a shareholder or shareholder group is not eligible to nominate a director, or that the proposed director is ineligible to serve as a director of the company under the proposed rule, the company must give notice to the shareholder or shareholder group of the deficiency within fourteen days of the filing of the Schedule 14N. A proper notice rejecting a nominee will include the basis for the exclusion. The nominating shareholder or group is then permitted a further fourteen calendar days to remedy the deficiency, if possible. However, the shareholder or shareholder group would not be able to substitute a new nominee or nominating shareholder (if the ineligibility of the nominating shareholder is the reason for the rejection).

If, after this opportunity to cure, the company believes that the nomination is still invalid, the company would be required to provide notice to the Commission and to the shareholder or shareholder group regarding the final determination of rejection. This rejection notice must be filed no fewer than 80 days before the company files its definitive proxy statement with the Commission with respect to its annual meeting of shareholders. The shareholder or shareholder group whose nomination had been rejected would then have 14 days to file a response to the notice filed by the company. The Commission staff could then, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or shareholder group as to whether or not it believes the rejection was proper.

Changes a company receiving a proper nominee for director must make to its proxy statement

Companies who include in their proxy statement a vote on a shareholder-nominated director would not be eligible to have a director vote involving voting for or withholding authority to vote for the company’s directors as a group. Rather, each director would have to be voted on separately. Shareholders or shareholder groups nominating a director for election would have the ability to include a statement of no greater than 500 words in the company’s proxy statement. Further, the company’s board of directors may recommend whether shareholders should vote for or against such shareholder nominated nominees.

In addition, the proposed rule exempts from the proxy rules virtually all communication by a shareholder or shareholder group to other shareholders in order to seek to form a group with holdings great enough to meet the requirements to nominate a director under the proposed rule. Further, a shareholder or shareholder group nominating a candidate for director would be allowed to solicit in favor of its nominee. However, such solicitation would be subject to certain limitations, including a ban on seeking to act as a proxy for other shareholders. Written communications would be subject to the requirement of filing with the Commission and any national securities exchange on which the company’s securities are registered at the time such written materials are first used.

In addition, the proposed rule includes proposed changes to Rule 14a-9 of the Exchange Act to ban any misleading or fraudulent communications by shareholders

“If the proposed changes to Rule 14a-8(i)(8) are adopted, companies would be required to include in their proxy materials shareholder proposals that would amend, or request and amendment to, the company’s governing documents concerning director nomination procedures or other director-nomination disclosure provisions that do not conflict with the rule as proposed to be amended.”

under the proposed rule. The company would not be responsible for any such fraudulent statement unless it knew of or had reason to know of the fact that the statement was false.

Affiliate Status under the Securities Act of 1933

Under the proposed rule, a nominating shareholder or each member of the shareholder group would not be deemed to be an affiliate of the company solely as a result of nominating a director or soliciting for such director or against the company’s nominees. Further, the shareholder would not be deemed an affiliate following the election of the shareholders’ nominee solely as a result of having nominated that director if the nominating shareholder does not have an agreement or relationship with that director other than relating to the nomination.

Impact of proposed NYSE Rule 452

The New York Stock Exchange (“NYSE”) has filed with the Commission a proposed change to NYSE Rule 452 relating to broker discretionary voting. Under the existing rule, brokers are permitted to vote shares they hold in street name in uncontested director elections. The rule, as amended, would eliminate that authority. As NYSE Rule 452 applies to registered brokers, its application potentially impacts director elections in all public companies and not just companies listed on the NYSE. The proposing release requests comments on the impact of the proposed amendment to NYSE Rule 452 in light of the anticipated operation of Rule 14a-11.

Proposed Amendments to Rule 14a-8

The Commission has also proposed amendments to Rule 14a-8(i)(8) to the Exchange Act. Under current Rule 14a-8, companies may omit shareholder proposals that relate to the nomination or election of directors from their proxy materials. If the proposed changes to Rule 14a-8(i)(8) are adopted, companies would be required to include in their proxy materials shareholder proposals that would amend, or request and amendment to, the company’s governing documents concerning director nomination procedures or other director-nomination disclosure provisions that do not conflict with the rule as proposed to be amended. Shareholder eligibility to propose a shareholder proposal would remain as it is under the current rule (which require the shareholder making the proposal to own at least \$2,000 of market value or 1% of the company’s shares for at least one year, whichever is less). However, any such proposed changes could not eliminate the requirements of shareholder access under proposed rule 14a-11 or make the requirements of such rule more restrictive (they can, however, be made more liberal).

The proposed rule change would also codify existing staff position to make clear that a company may exclude a proposal that would disqualify a nominee who is standing for election, remove a director from office before his or her term expires, question the competence, business judgment or character of one or more nominees or directors, nominate a specific individual for election to the company’s board of

directors (otherwise than pursuant to Rule 14a-11, applicable state law or the company's governing documents), or otherwise could affect the outcome of an upcoming election of directors.

Reading the Tea Leaves

The Commission will likely receive many comments on the proposed rules, both favorable and unfavorable. Those who support the proposal will argue that it will make boards of directors responsive to shareholders and help force directors to be accountable to the company's owners. Those who oppose the proposal are likely to argue that it is bad public policy for the Commission, in its rules, to usurp state corporate law and give shareholders rights they do not otherwise have under state law. Opponents will also express the concern that the rule will favor activist shareholders with an agenda that is not necessarily one that is in the long-term best interest of the company's shareholders. There may also be a legal challenge to any final rules adopted by the Commission in which it will likely be argued that the shareholder access rules along the lines of the proposed rules would exceed the Commission's authority under Section 14(a) of the Exchange Act, which only authorizes the Commission to create rules and regulations pertaining to the solicitation of proxies.

There were extensive comments on these same issues in connection with the Commission's 2003 and 2007 proposals. Politics being what they are today, it appears that the Commission will likely adopt some form of proxy access rule so that it is in place for use during the 2010 proxy season. Companies should therefore recognize that they will likely need to deal with rules giving shareholders access to the proxy statement even if these rules are later challenged in court.

Potential Action Items for Public Companies

Public companies may want to consider several possible courses of action at this time:

Comment on the Proposal. The proposal asks almost 500 questions about how the proposed rule ought to operate. Public companies may wish to comment on the proposals and help shape the final form of the rules. In that regard, we believe that the Commission will look favorably upon comments that focus on making the rules as practical as possible.

Bylaw Changes. Companies should review their advance notice bylaws and consider whether modification will be necessary if the shareholder access rules are adopted as proposed. They should also affirmatively consider adopting bylaw amendments that permit shareholder access.

Vote standard for election of directors. If a company has adopted non-plurality voting standards that apply to the election of directors, such as a majority voting standard, it should review that standard to determine what effect the inclusion of the proposed rule will have on votes for election of directors by its shareholders. Changes to majority voting bylaws may be necessary so that where the number of nominees exceeds the number of director vacancies a plurality vote standard will apply.

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Size of Board. The proposed rule would permit nominating shareholders to nominate one director or up to 25% of the board, whichever is greater. If the 25% cap does not result in a whole number, the maximum number of directors that could be nominated would be rounded down. Because the proposal rounds down, the size of the board could affect the impact of this proposal on the company. As a result, companies may wish to consider adjustments to the size of their board of directors.

Concerns relating to shareholder nominees. Governance committees should consider the likelihood that shareholders will nominate directors and determine whether to reach out to significant shareholders to avoid possible nominations by shareholders under the new rules.

Companies incorporated outside of Delaware should also analyze the corporate law in their jurisdiction of organization regarding a shareholder's ability to include director nominations in the company's proxy statement to assess whether there is a conflict between state law and the proposed rules. They should also monitor any proposed state law changes that may impact the proxy access process.

Since it is anticipated that the Commission will seek to finalize the new rules so that they will be available for use during the 2010 proxy season, companies who hold their shareholder meetings early in the year may need to make decisions on these issues while the proposed rules are still pending. Early consultation with counsel and monitoring of the rules as it develops during the comment period will be important tasks for issuers seeking to maintain control over the nominations process next year.

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For further information or for help in assessing how the proposed new rules might affect your company, please contact your principal lawyer at the firm or one of the Akerman shareholders listed below.

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