

August 26, 2010

## SEC Adopts Final Proxy Access Rules

At an open meeting of the U.S. Securities and Exchange Commission (the “SEC”) held on August 25, 2010, the SEC Commissioners voted (by a margin of 3-2) to adopt final rules (the “Final Rules”) that amend the federal proxy rules under the Securities Exchange Act of 1934 (the “Exchange Act”). The Final Rules come more than a year after the SEC’s most recent rule proposals on proxy access were issued in May 2009 (the “Proposed Rules”) and more than seven years after the SEC first issued proxy access rule proposals in May 2003. In adopting the Final Rules, the SEC noted that “as a matter of fairness and accountability, long-term shareholders should have a means of nominating candidates to the boards of the companies that they own.”

The adopting release addressed the arguments of some commentators that proxy access is no longer necessary in light of the shift towards majority voting in uncontested elections and the amendments to NYSE Rule 452 regarding who votes in director elections, by stating that, “While these and other changes have been important events, they bolster shareholders’ ability to elect directors who are already on the company’s proxy card, not their ability to affect who appears on that card.” The SEC also addressed arguments that had been made regarding its authority to adopt the Final Rules and their constitutionality in light of the First Amendment. With respect to the former, it noted that Congress had removed any doubt regarding the SEC’s authority to adopt the rules (which the SEC believed was never an issue, in any event, under Section 14(a) as originally enacted). With respect to the latter, it stated that “proxy regulations do not infringe on corporate First Amendment rights both because ‘management has no interest in corporate property except such interest as derives from its shareholders,’ and because such regulations ‘govern speech by a corporation to itself’ and therefore do not limit the range of information that a corporation may contribute to the public debate.”

Notably, the Final Rules do not require a company to “opt in” to proxy access nor allow a company’s shareholders to “opt out” of proxy access, as many commentators had recommended. The Final Rules, however, do permit a company’s governing documents to provide for additional ways of including shareholder nominees in the company’s proxy materials. Further, the SEC indicated that the Final Rules defer to state law with respect to whether shareholders have the right to nominate directors.

Although the Final Rules are quite similar to the Proposed Rules, several important changes are reflected in the Final Rules in response to the hundreds of comment letters submitted on the Proposed Rules. The amendments will become effective 60 days after they are published in the Federal Register, and therefore will be in effect for the 2011 proxy season and apparently for 2010 annual meetings to be held in late 2010. While the access rules apply to smaller companies (generally those with a public float of less than \$75 million), the SEC has delayed the effective date for compliance by these companies for three years.

## Shareholder Nominees to be Included in Company Proxy Materials

New Rule 14a-11 under the Exchange Act will permit eligible shareholders (including groups of shareholders) to include their nominee(s) for director in a company's proxy materials so long as such shareholders are not otherwise prohibited by applicable state or foreign law or the company's governing documents from nominating candidates for election as a director. The rules apply to all companies that are subject to Exchange Act proxy rules, including investment companies, "controlled" companies (despite observations of some commentators that applying the rules to controlled companies will, in many instances, be an exercise in futility), companies that voluntarily register a class of equity securities under Section 12(g) of the Exchange Act, and, after three years from their adoption, smaller reporting companies. They do not apply to companies that are subject to the proxy rules solely because they have a class of debt securities registered under Section 12 of the Exchange Act, nor do they apply to foreign private issuers (who are exempt from the SEC's proxy rules).

To be eligible, a shareholder (or group) must have beneficially held both voting and investment power over securities representing at least 3% of a company's voting power continuously for the three years prior to submitting its nomination to the company; there is no minimum ownership threshold for individual members of a group. These ownership threshold and holding period requirements differ from the 1%-5% ownership thresholds (based on a sliding scale in accordance with the company's market capitalization) and one-year holding period included in the Proposed Rules. The Final Rules also provide that short positions in securities must be deducted when calculating the required ownership threshold, and that the right to acquire securities underlying options cannot be counted toward the required ownership threshold.

Shareholders in the aggregate will not be able to nominate more than one nominee, or nominees representing 25% of the company's board of directors, whichever is greater (the "maximum number of nominees"). Nominating shareholders must certify that they are not holding the company's securities with the purpose or effect of changing control of the company or to gain representation on the board of directors in excess of the maximum number of nominees. If a company receives shareholder nominations for more than the maximum number of nominees, then it must include in its proxy materials the nominees of the shareholder(s) holding the highest percentage of voting power, up to the maximum number of nominees. This approach differs from the "first-in" approach reflected in the Proposed Rules. The Final Rules also clarify that this 25% limitation relates to the size of the full board in the event a company has a staggered board.

Notice of a shareholder or group's nomination must be provided to the company between 120 and 150 days prior to the anniversary of the date on which the company mailed its proxy materials for the prior year's annual meeting. This requirement differs from the Proposed Rules, which would have required the shareholder or group to provide notice to the company no later than the date specified in the company's advance notice provision or, if the company did not have an advance notice provision, no later than 120 calendar days before the anniversary of the mailing of the prior year's proxy statement.

In addition, nominees must satisfy the objective independence standards of the applicable national securities exchange or national securities association and the nominating shareholder(s) must not have any agreement with the company regarding the nomination of the nominee.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

Nominating shareholder(s) must file with the SEC and submit to the company a new Schedule 14N, which will include disclosure of the amount and percentage of securities owned by the nominating shareholder(s), the length of ownership, a statement of the shareholder's intent to hold the securities through the meeting date and certain representations and information about the nominating shareholder(s) similar to those currently required in contested proxy solicitations. The company must include this information in its proxy materials.

Under new subsection (c) to Rule 14a-9, a nominating shareholder and each member of a group will be liable for false or misleading statements that are included in its Schedule 14N or provided by it to the company in connection with a Rule 14a-11 nomination proposal. The company will not be responsible for any information provided by the nominating shareholder(s) and included in the company's proxy statement.

If a company wishes to challenge the validity of a shareholder's nomination, the company must provide notice of its intent to exclude the nomination (and may seek a related no-action letter from the SEC), no later than 80 calendar days before the company files its definitive proxy materials, after having first provided a written notice of deficiency to the nominating shareholder or group and permitting the shareholder to correct technical deficiencies in its nomination.

### Narrowing the "Election Exclusion" for Shareholder Proposals under Rule 14a-8(i)(8)

Rule 14a-8(i)(8) under the Exchange Act currently permits companies to exclude from their proxy materials shareholder proposals that "relate to an election." The amendments to 14a-8(i)(8) set forth in the Final Rules narrow this so-called "election exclusion" so that it applies only to proposals that (i) would disqualify a nominee standing for election, (ii) would remove a director from office before the expiration of his or her term, (iii) question the competence, business judgment or character of a nominee or director, (iv) seek to include a specific individual in the company's proxy materials for election to the board or (v) otherwise could affect the outcome of the upcoming election of directors. As a result, a company may no longer rely on Rule 14a-8(i) to exclude shareholder proposals that would amend, or that request an amendment to, nominating procedures or director nomination disclosure requirements set forth in a company's governing documents. The SEC stated that the revisions "will provide an additional avenue for shareholders to indirectly exercise" their state law rights to nominate directors.

The provisions of Rule 14a-8 regarding a shareholder's eligibility to submit proposals for inclusion in a company's proxy materials will continue to apply, such that a shareholder proponent must have continuously held at least \$2,000 in market value (or 1%, 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.

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## Related Amendments to Regulation 13D

The Final Rules include related amendments to Regulation 13D which exempt from the filing requirements of Rule 13d-1 solicitations by shareholders seeking to form a Rule 14a-11 nominating group and solicitations by Rule 14a-11 nominating shareholder(s) in support of their director nominee. The amendments to Regulation 13D also clarify that a shareholder will not lose its Schedule 13G eligibility solely as a result of making a Rule 14a-11 nomination, soliciting in favor of a nominee or having a nominee elected to the board.

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