

# Securities

## ADVISORY

May 21, 2009

### SEC Proposes Adoption of "Shareholder Access" Rule

Yesterday, in a less than unanimous vote, the U.S. Securities and Exchange Commission ("SEC") proposed amendments to the proxy rules that would let shareholders require public companies to include director nominees of those shareholders in company proxy materials. The following is a brief summary of the proposed amendments based on the SEC's public statements discussing the proposal. The text of the amendments is expected to be made available later this month.

#### NEW RULE 14A-11

The centerpiece of the amendments is proposed Rule 14a-11, which, if adopted, would entitle a shareholder meeting the requirements discussed below to include its nominee to the board of directors in a company's proxy materials, as long as the shareholder has the right to nominate directors under applicable state law and the company's governing documents.<sup>1</sup> All public companies and registered investment companies that are subject to the proxy rules would be subject to the new rule.

#### MINIMUM OWNERSHIP REQUIREMENTS

In order to rely on Rule 14a-11, a shareholder (or a group of shareholders that aggregate their holdings) would have to own a minimum number of the company's voting securities for at least one year as of the date that the shareholder notifies the company of its proposed nomination.<sup>2</sup> The minimum ownership requirement is tiered according to company size, as follows:

- for large accelerated filers (companies with a market float of at least \$700 million) and registered investment companies with net assets of \$700 million or more, the minimum ownership requirement would be 1%;
- for accelerated filers (companies with a market float of at least \$75 million) and registered investment companies with net assets between \$75 million and \$700 million, the minimum ownership requirement would be 3%; and

<sup>1</sup> Unlike the shareholder access rules considered by the SEC in 2003, proposed Rule 14a-11 would not be predicated on a triggering event. Under those proposals, a company would have been required to include the nominees of shareholders owning more than 5% of the company's stock in its proxy materials if one of two triggering events occur: first, if the company's shareholders approved a Rule 14a-8 shareholder proposal to subject the company to a shareholder nomination procedure; or second, if one of the company's nominees for the board received "withhold" votes from more than 35% of the votes cast. Once triggered, the shareholder nomination procedure would have permitted an eligible shareholder to nominate up to three candidates to the board, depending on the size of the company's board. See *Security Holder Director Nominations*, SEC Rel. No. 34-48626 (Oct. 14, 2003).

<sup>2</sup> As described, the ownership test is to be based on percentage of "voting securities," not percentage of the vote. This may be the subject of comment on the proposal, as the described standard would not take into account classes of securities with differing voting rights.

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- for non-accelerated filers (companies with a market float of less than \$75 million) and registered investment companies with net assets of less than \$75 million, the minimum ownership requirement would be 5%.

### **NOMINATION REQUIREMENTS**

For a nomination to be eligible for inclusion in a company's proxy statement under Rule 14a-11, the nomination must not violate applicable law, and the nominee must satisfy the independence standards of the national securities exchange on which the company's securities are listed. Further, the nominating shareholder may not have any direct or indirect agreement with the company regarding the shareholder's nomination.

### **NUMBER OF CANDIDATES WHO CAN BE NOMINATED**

Rule 14a-11 would allow shareholders to nominate the greater of one nominee or 25% of the number of board seats that are up for election.<sup>3</sup> For example, with a 12-member board up for election, shareholders could present up to three candidates for election, whereas with a class of three directors on a classified board standing for election, shareholders could nominate up to one candidate. If more nominees are submitted than would be permissible under the rule, a company would be required to include in its proxy materials only the nominees put forward by the nominating shareholder who first provided timely notice to the company.

### **DISCLOSURE REQUIREMENTS APPLICABLE TO A NOMINATING SHAREHOLDER**

The SEC is proposing that a nominating shareholder provide a company, and file with the SEC, a new Schedule 14N, disclosing a variety of matters, including:

- the amount and percentage of securities owned by the nominating shareholder,
- the length of time of the nominating shareholder's ownership,
- information about the nominating shareholder and nominees that is the same as would be required in a proxy contest, and
- the nominating shareholder's intent to continue to hold the securities through the date of the meeting.<sup>4</sup>

Schedule 14N also would require that the nominating shareholder certify that it is not seeking to change control of the company or to gain more than minority representation on the board of directors.<sup>5</sup> According to statements made at the open meeting, this notice must be provided within the time frames provided by a company's advance notice bylaw provisions. In the absence of such provisions, such notice must be provided within 120 days in advance of the anniversary of the distribution date of the proxy statement for the prior year's shareholder meeting (the same deadline used for Rule 14a-8).

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<sup>3</sup> As described, there is no indication as to whether rounding up or down will be appropriate when using the 25% test, an important issue given that most boards have odd numbers of members. It is also not clear whether the limit on numbers of candidates will need shaping in the context of classified boards.

<sup>4</sup> These disclosure requirements are less extensive than those contemplated by the 2007 shareholder access proposals.

<sup>5</sup> Here, too, the public descriptions raise questions for further consideration when the proposed rules are published and for the comment process. How, for instance, would a shareholder who had successfully nominated 25% of the board in year one be able to certify in year two a lack of control intent if the shareholder wanted to use the access rule in year two? Or, alternatively, how would a shareholder in year one be able to certify to a lack of control intent, if that shareholder had designs on further use of the access rules in later years?

The SEC also is proposing to require that a company include disclosures in its proxy materials regarding the nominating shareholder and the shareholder nominee or nominees. According to the SEC's press release, these disclosures would be similar to the disclosures currently required in a contested election.

### **COORDINATION WITH ACCESS RIGHTS UNDER STATE LAW**

Although the issue is not addressed in the press release, according to statements made during the open meeting proposing the amendments, the rights created by Rule 14a-11 are meant to be in addition to, but not in lieu of, any shareholder access right applicable to a company under its governing documents or applicable state law. For example, it was noted that a company that already has adopted a shareholder access bylaw with different thresholds than those created by Rule 14a-11 would have to comply with 14a-11 in addition to its own bylaw. In practical terms, that could mean that a company with a bylaw that establishes a 10% threshold for nominations to the board to be included in the proxy would also have to include in its proxy statement nominations by shareholders who satisfy Rule 14a-11's lower thresholds. It is this tension with state law, among others, that has prompted reports of possible litigation challenges to the proposed rule.

### **AMENDMENTS TO RULE 14A-8**

In addition to proposed Rule 14a-11, the SEC has proposed amending Rule 14a-8 to permit the submission of proposals by shareholders to establish a shareholder access regime under a company's governing documents, as long as such proposals do not conflict with new Rule 14a-11 or other SEC rules. Under this amendment, Rule 14a-8(i)(8) would be revised to treat shareholder access bylaws like other election-related procedural shareholder proposals, which generally may not be excluded as relating to an election of directors.

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