

ADVISORY | Securities

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SEC ADOPTS “SHAREHOLDER ACCESS” RULES

Today, by a 3-2 vote and with explicit authority granted to it under the Dodd-Frank Wall Street Reform and Consumer Protection Act,¹ the U.S. Securities and Exchange Commission (“SEC”) adopted amendments to its proxy rules that will require that a public company include in its proxy materials candidates to the board who have been nominated by shareholders who meet certain conditions. The amendments will also require companies to include in their proxy materials, under certain circumstances, shareholder proposals that seek to establish a procedure in a company’s governing documents for the inclusion of shareholder director nominees in the company’s proxy materials. The following is a brief summary of the amendments, which will take effect 60 days after publication in the Federal Register.²

New Rule 14a-11

The centerpiece of the amendments is Rule 14a-11, which requires that a company include in its proxy materials the nominees to the board of directors of one or more shareholders who meet the requirements discussed below.

Companies Subject to the Rule

All public companies and registered investment companies that are subject to the proxy rules are subject to the new rule. The rule will not apply to smaller reporting companies (i.e., companies with a market float of less than \$75 million), however, for three years.³

Minimum Ownership Requirements

In order to rely on Rule 14a-11, a shareholder (or a group of shareholders that aggregate their holdings) must continuously own at least 3% of the total voting power of a company’s securities for three years as of the date that the shareholder notifies the company of its proposed nomination.⁴ This contrasts with the proposed rule, which called for a tiered minimum ownership amount based

¹ See Section 971 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amends Section 14 of the Securities Exchange Act of 1934 regarding the SEC’s authority to adopt shareholder access rules.

² See Rel. No. 33-9136 (Aug. 25, 2010) (the “Adopting Release”). The text of the final rules is included in the Adopting Release which is available on the SEC’s website at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

³ Because “foreign private issuers” are not subject to the SEC’s proxy rules, they are not subject to Rule 14a-11. Foreign companies otherwise subject to the proxy rules that do not qualify as foreign private issuers, however, would be subject to the rule.

⁴ The ownership test is based on percentage of “voting power” of the company’s securities entitled to be voted at the meeting, rather than as a percentage of outstanding securities. Accordingly, where a company has multiple classes of stock with unequal voting rights and the classes vote together on the election of directors, voting power would be calculated based on the collective voting power of all such classes.

on the size of a company's market float.⁵ For shares to be counted as being owned by a nominating shareholder, the shareholder must have both voting power and investment power over such shares.

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 objective independence standards of the national securities exchange on which the company's securities are listed. Further, neither the nominating shareholder nor the nominee may have any direct or indirect agreement with the company regarding the shareholder's nomination.

Number of Candidates Who Can Be Nominated

Rule 14a-11 allows shareholders to nominate the greater of one nominee or up to 25% of the number of total board seats. For example, with a 12-member board, shareholders could present up to three candidates for election. 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 largest shareholder who has made a valid nomination.

Deadline for Nominations

Under Rule 14a-11, a nominating shareholder must notify a company of its intent to make a nomination no earlier than 150 calendar days and no later than 120 calendar days before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting.⁶ Based on the effectiveness date for Rule 14a-11, 60 days after publication in the Federal Register, it appears that qualifying shareholders of most calendar year-end companies will be eligible to make nominations under the rule in time for the 2011 proxy season. More specifically, for example, if the rules become effective on November 1, 2010, Rule 14a-11 generally would be available to shareholders of companies that mailed their proxy statement for their 2010 annual meeting on or after March 1, 2010.

Disclosure Requirements Applicable to a Nominating Shareholder

A nominating shareholder must 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,
- the nominating shareholder's intent to continue to hold the securities through the date of the meeting, and
- whether the nominee satisfies the director qualification requirements, if any, as set forth in the company's governing documents.

⁵ In order to achieve the minimum ownership threshold, securities that are owned but have been loaned may be counted, provided that they will be called back by the shareholder, but securities which are borrowed or sold short may not be counted.

⁶ If the company did not hold an annual meeting during the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, then the nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials, as specified by the company in a Current Report on Form 8-K under new Item 5.08. The Form 8-K must be filed within four business days after the company determines the anticipated meeting date.

Schedule 14N also requires 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.

The SEC also amended the proxy rules to require that a company include disclosures in its proxy materials regarding the nominating shareholder and the shareholder nominee or nominees. These disclosures would be similar to the disclosures currently required in a contested election. The nominating shareholder or group would be liable for any false or misleading statements it makes about the nomination, regardless of whether the statements are included in the company's proxy materials. A company will not be responsible for information provided by the nominating shareholder or group and then reproduced in the company's proxy materials.⁷

Coordination with Access Rights Under State or Foreign Law

The rights created by Rule 14a-11 are meant to be in addition to, but not in lieu of, any more restrictive shareholder access right applicable to a company under its governing documents or applicable state or foreign law. For example, a company that already has adopted a shareholder access bylaw with more restrictive ownership thresholds than those in Rule 14a-11 would have to comply with 14a-11 in addition to its own bylaw. In practical terms, that means 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 ownership threshold. In the case where applicable state or foreign law or a company's governing documents provide a shareholder access right that is less restrictive than Rule 14a-11, for example by setting an ownership threshold below the 3% threshold of Rule 14a-11, shareholders who own less than 3% of such a company's voting power would have the right to make nominations under the applicable state or foreign law (or governing documents) but not under Rule 14a-11.⁸

A company will not be subject to Rule 14a-11 if applicable state or foreign law, or the company's governing documents, prohibit shareholders from nominating board candidates.⁹

Amendments to Rule 14a-8

In addition to Rule 14a-11, the SEC amended 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 or limit new Rule 14a-11 or other SEC rules. Under this amendment, Rule 14a-8(i)(8) is 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.¹⁰ A shareholder who makes a nomination in reliance on such an access procedure, must,

⁷ A nominating shareholder may submit a statement of support for the nominee that is no longer than 500 words to be included in the proxy statement.

⁸ See Adopting Release at 38-39. Also, in situations where applicable state or foreign law or a company's governing documents are more permissive than Rule 14a-11 in some respects but more restrictive than Rule 14a-11 in other respects, a shareholder could choose to proceed under the alternate procedures provided by applicable state or foreign law or the company's governing documents, but would be required to clearly evidence its intent to rely on such alternate procedure and meet all of the requirements of such alternate procedure, as well as providing the disclosures required by new Rule 14a-18.

⁹ Of course, if a company's governing documents prohibit shareholders from nominating board candidates, shareholders could seek to amend the governing documents, to the extent permitted by applicable law, by submitting a shareholder proposal pursuant to Rule 14a-8.

¹⁰ The amendments to Rule 14a-8 also codify a number of interpretive positions that the staff of the SEC has historically taken with respect to Rule 14a-8(i)(8).

much like a nomination under Rule 14a-11, file a Schedule 14N with the SEC to notify the company of its intent to make such a nomination.¹¹

Other Changes

In connection with the adoption of Rule 14a-11, the SEC adopted exemptions from the proxy rules for solicitations by a shareholder that is seeking to form a nominating group and solicitations in support of a shareholder nominee for director.¹² Reliance on these exemptions will require the shareholder or group to file on Schedule 14N any written materials published, sent or given to shareholders and notice of any oral solicitations.

The SEC also amended its beneficial ownership reporting rules so that shareholders relying on Rule 14a-11 would not become ineligible to file beneficial ownership reports on Schedule 13G, in lieu of filing on Schedule 13D, solely as a result of activities in connection with reliance on Rule 14a-11. However, the SEC did not adopt an exclusion from Exchange Act Section 16 for groups formed solely for the purpose of nominating a director under Rule 14a-11, nor did it adopt a safe harbor providing that a nominating shareholder would not be deemed an “affiliate” of the company as a result of using Rule 14a-11.

In addition to the amendments described above, the SEC added a new disclosure item to 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. A registered investment company that is a series company is required to disclose on Form 8-K the total number of the company’s shares that are entitled to vote for the election of directors at the annual meeting (or, in lieu of an annual meeting, a special meeting) as of the end of the most recent calendar quarter.

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The SEC’s action today is the culmination of a lengthy and, at times, torturous rulemaking, one that divided the SEC’s five Commissioners from beginning to end. Much of the controversy underlying the rulemaking was along policy and philosophical lines. For now, with a final rule in hand, those debates will necessarily recede. However, much controversy has also surrounded the likely administrative and interpretive complexities in a shareholder access regime. Those debates, far from receding, will now be grounded in a new reality and likely to play out strongly over the ensuing months.

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¹¹ See Rule 14a-18. A shareholder who submits a nomination pursuant to a state law provision or a provision in a company’s governing documents would be required to file a Schedule 14N (with the disclosures required by that Schedule) by the date specified in the advance notice provision, or where no such provision is in place, no later than 120 calendar days before the anniversary of the date the company mailed its proxy materials for the prior year’s annual meeting.

¹² See Rules 14a-2(b)(7) and 14a-2(b)(8).

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