On August 25, 2010, the SEC adopted “proxy access” rules that, under certain circumstances, will require a U.S. public company to include shareholder nominees for election as directors in its proxy materials. Currently, a shareholder cannot require a company to include a director nominee in the company’s proxy materials. The SEC also amended Rule 14a-8 to allow for shareholder proposals that would broaden proxy access. Following is a summary of the new rules; commentary can be found here.

The new rules, which will be applicable to most companies in the 2011 proxy season, will revise the proxy rules in two significant respects:

- **Access for nominees**: New Exchange Act Rule 14a-11 will permit shareholders that have continually owned a minimum of three percent of a company’s voting stock (alone or with other members of a “group”) for a three-year period to nominate up to 25% of the company’s board of directors and solicit proxies for those nominees using the company’s proxy statement. In order to avail themselves of the new rule, nominating shareholders will have to provide disclosure regarding the nominee and the nominating shareholders and make several representations and certifications, including a certification that they do not hold their shares for the purpose or with the effect of changing control of the company or to gain more than the permissible number of board seats.

- **Process proposals**: The Rule 14a-8(i)(8) “election exclusion” will be repealed so that companies generally will no longer be able to exclude shareholder proposals dealing with the director nomination process unless the proposal limits the availability of Rule 14a-11 – i.e., proposals to establish more lenient “proxy access” generally would be permitted under Rule 14a-8.

The new rules will become effective 60 days after they are published in the Federal Register, except with respect to smaller reporting companies (generally companies with a public float of less than $75 million) that will not have to comply until three years after the effective date.

**Rule 14a-11**

Rule 14a-11 will apply to all companies subject to the proxy rules (including controlled companies and companies registered under the Investment Company Act), other than companies that are subject to the Exchange Act solely because they have a class of registered debt. Since foreign private issuers are exempt from the proxy rules, the new rule will not apply to them. Companies may not opt out of Rule 14a-11 (even through a shareholder vote) and will be subject to the rule even if they are facing a concurrent proxy contest or nomination under state law.

**Eligibility**

A shareholder or group will be able to require that shareholder nominees be included in the company’s proxy materials if the nominating shareholder or group meets the following criteria:

- **Minimum ownership and holding period requirements.** The shareholder or group of shareholders has held at least three percent of the voting power of the company’s securities that are entitled to be voted on the election of directors for at least three years (as of the date of the filing of a Schedule 14N disclosing the nomination) and intends to continue to hold those securities through the date of the meeting and thereafter.

In calculating the ownership level, only those shares over which the nominating shareholder or group has current voting and investment power may be counted. Borrowed shares and shares that have been sold in a short sale may not be included. However, shares loaned to others may
be included so long as the nominating shareholder or group can recall the securities and will recall the securities upon being notified that any of its nominees will be included.

A written statement from the record holder or the banks or brokers through which the shares are held must be filed with the SEC verifying the required level of ownership as of a date that is within seven days prior to filing of the notice. Schedule 14N provides a form. Alternatively, the nominating shareholder or each member of the nominating shareholder group may attach a current beneficial ownership filing containing the required information.

- **Submission of timely notice on Schedule 14N.** The nominating shareholder or group must file on EDGAR and send to the company on the same day a Schedule 14N containing required disclosures, representations and certifications within the time periods described below.

- **Certification of no “control” purpose.** The nominating shareholder or group must certify on Schedule 14N that the shares were not acquired “with the purpose, or with the effect, of changing control” of the company or to gain a number of seats on the board that exceeds the maximum number of nominees that the company is required to include under the rule. In addition, a nominating shareholder or any member of a nominating shareholder group must not be a participant in another nomination, or proxy contest, with respect to the same election.

- **Independence of nominee.** The nominee must satisfy the “objective” director independence criteria of the applicable stock exchange (or, in the case of an investment company, the nominee must not be an “interested person” under the Investment Company Act). However, the nominee need not satisfy any “subjective” independence standards or meet stricter criteria established by individual companies. In addition, Rule 14a-11 does not require that the nominee be independent of the nominator or any member of the nominating group.

- **No agreements with the company.** The nominating shareholder or group must not have any agreements with the company or an affiliate of the company with respect to the nomination prior to the submission of the Schedule 14N. However, if the company decides to include a shareholder nominee on the company proxy card as a company nominee, the company can count the nominee toward the 25% cap so long as the company did not have an agreement or enter into negotiations with the shareholder(s) before the shareholder filed its notice on Schedule 14N.

- **Conformity with law.** The nominee’s candidacy or board membership must not violate law or applicable stock exchange rules (other than with regard to “subjective” independence criteria).

A nominating shareholder’s ability to use Rule 14a-11 will not be limited by prior unsuccessful uses of the rule.

**Number of Nominees**

A company will be required to include in its proxy materials up to 25% of the company’s board of directors (rounded down) or, if a board has three or fewer directors, one director. If the company has a staggered board, any director who was elected pursuant to Rule 14a-11 whose term extends past the election will count toward the 25% cap. If a company decides to nominate an incumbent director who was a shareholder nominee in a prior election, that director will not count toward the 25% cap. If multiple classes are entitled to elect a specified number of directors, the company will be required to include the number of director seats that the class of shares held by the nominating shareholder is entitled to elect or 25% of the entire board, whichever is less.

If the company receives competing nominations, access under Rule 14a-11 will be allocated giving preference to the nominating shareholder or group with the highest qualifying voting percentage. If a shareholder or group nominates less than the number of individuals it is entitled to nominate under the rule (or if a nominating shareholder or group withdraws or is disqualified), the company must include the
nominees of the shareholder with the next highest qualifying ownership percentage, and so on, up to the 25% cap. If a shareholder nominates more individuals than it is entitled to under Rule 14a-11, the shareholder will be permitted to choose among its nominees in order to reduce its nominees to the correct number. If a nominee withdraws or is disqualified prior to the company’s printing of proxy materials, the company must substitute any other eligible nominee submitted by that nominating shareholder or, if no other nominees were submitted, the nominees of the shareholder with the next highest voting power percentage. If a nominating shareholder, group or nominee withdraws or is disqualified after a company begins printing its proxy materials, the company will no longer be required to include substitute nominees but may furnish additional proxy materials regarding the developments.

Notice and Disclosure

Under Rule 14a-11, a shareholder or group must file with the SEC and provide to the company a Schedule 14N during a window of time that is no earlier than 150 calendar days and 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 (or the next business day if the deadline falls on a Saturday, Sunday or holiday). An amendment to Rule 14a-5 will require companies to disclose this deadline in its proxy statement for the next year’s annual meeting. If the company did not hold an annual meeting in the prior year or if the meeting date was changed by more than 30 days, the company must disclose under a new Item 5.08 to Form 8-K the date by which a nominating shareholder must submit its Schedule 14N, which date must be a reasonable time before the company mails its proxy materials.

The Schedule 14N must contain the certifications and representations regarding eligibility described above and disclosures regarding the shareholder nominee and the nominating shareholder or group similar to the disclosure required in a proxy contest and must be promptly amended for any material changes. In addition, it must also include:

- disclosure describing any relationship between the nominating shareholder and nominee as well as any relationship with the company or any of its affiliates;
- certain information regarding the nominating shareholder or group’s ownership of shares including with respect to securities that have been loaned to others, borrowed or sold in a short sale and the nominating shareholders’ or group’s intent with respect to continued ownership of the shares following the election; and
- disclosure regarding whether the nominee(s) satisfies the company’s director qualifications standards.

If the company includes a shareholder nominee in its proxy materials under Rule 14a-11, the company will be required to include in its proxy materials certain disclosures from Schedule 14N similar to the disclosure required in a traditional proxy contest as well as certain other disclosures, including an up to 500-word statement of support for each nominee by the nominating shareholder or group.

Liability for false and misleading statements.

A new Rule 14a-9(c) will prohibit a nominating shareholder or group from causing any false or misleading statements to be included in a company’s proxy materials. The rule will also prohibit the inclusion of such statements in a Schedule 14N or other soliciting communications regardless of whether the statements ultimately appear in the proxy statement. The company will not be liable for any information contained in the company’s proxy statement that was provided by a nominating shareholder. Moreover, none of the information provided by a shareholder and included in the company’s proxy materials will be incorporated by reference into any of the company’s SEC filings, unless the company specifically incorporates it, in which case, it will be treated as the company’s disclosure for purposes of the anti-fraud rules.
Process for Determining Eligibility

Once a company receives a Schedule 14N, it must determine whether it can exclude the nominee. If the company is not able to exclude the nominee, it must notify the shareholder or group no later than 30 days before the company files its definitive proxy statement with the SEC that it will include the nominee.

Reasons for excluding a nominee.
A company may exclude a nominee under Rule 14a-11(a) only for the following reasons:

- Rule 14-11 is not applicable to the company;
- The nominating shareholder or group failed to satisfy the rule’s eligibility requirements; or
- The company received more nominees than it is required to include.

The company may not assert that a certification or disclosure provided by a nominating shareholder or group is false or misleading as a basis for exclusion and may not use this reasoning as a basis to seek a no-action letter from the SEC. Moreover, a company will not be able to exclude disclosure from its proxy materials because it believes the information is false or misleading. However, a company may provide additional disclosure regarding the reasons it believes the disclosure is incorrect.

Procedures for excluding a nominee.
If the company determines it may exclude a nominee (or the 500-word statement submitted by the nominating shareholder(s) because it exceeds the maximum number of words), the company must notify the nominating shareholder or group within 14 calendar days after the expiration of the deadline for submission of a nominee pursuant to the rule. If after 14 calendar days of the notice the shareholder is not able to cure the deficiency, the company can exclude the nominee by filing a notice to that effect with the SEC, with a copy to the nominating shareholder or group, no later than 80 calendar days before the company files its definitive proxy statement with the SEC, or later upon a showing of good cause. (Note that the shareholder may not change the composition of the nominating shareholder group or the identity of the shareholder nominee to correct a deficiency.)

At this time, the company may choose to file a no-action request with the SEC. The company will have the burden of demonstrating why the nominee can be excluded. If a company files a no-action request, within 14 calendar days of receipt of the company’s no-action request to the SEC, the nominating shareholder or group may submit a response to the SEC staff. The staff will then, at its discretion, provide a no-action letter with its views. Promptly thereafter, the company must provide the nominating shareholder or group with notice of whether it will include the shareholder’s nominee(s).

Other Changes

Proxy Solicitations by Nominating Shareholders.
Rule 14a-2(b)(7) will allow a shareholder to freely communicate with any number of shareholders “in connection with the formation of a nominating shareholder group” as an exempt solicitation so long as any written communications for this purpose are filed with the SEC under Schedule 14N at the time the communication is made and contain only limited information, including the shareholder's intent to form a nominating shareholder group, a brief statement of potential nominees, the percentage of voting shares held and the means to contact the shareholder. Oral communications will also be permitted at any time after the shareholder files a “notice of commencement” on Schedule 14N, which means that a company could receive notice of a potential Rule 14a-11 filing prior to the notice period. A shareholder may not use this exemption if it intends to effect a change of control or gain more than the permitted number of seats on the company's board.

Once the nominating shareholder or group receives notice that the company intends to include its nominee(s) in its proxy statement, the nominating shareholder or group will be permitted under Rule 14a-2(b)(8) to communicate freely, orally or in writing, with all shareholders in support of its nominee or
against the company’s nominees so long as (i) they do not furnish a form of proxy or otherwise seek the power to act as proxy, (ii) specified legends are included on all written communications and (iii) all soliciting material that is published, sent or given to shareholders is filed with the SEC on Schedule 14N.

Proxy Mechanics and Voting.
New Rule 14a-4(b)(2)(iv) will require a company that includes a shareholder nomination in its proxy materials to use a “universal proxy” in which each nominee for director is listed on the proxy card. Since there will be more nominees than directorships, the proxy card will only allow shareholders to deliver a proxy for up to the number of seats up for election. While the company is allowed to indicate for each nominee whether the board recommends a vote “for” the nominee, the company cannot otherwise discriminate among the nominees and cannot provide shareholders with the ability to check a box and vote for the entire company-recommended slate. Under virtually all majority vote standards, the election of directors reverts to a plurality vote in a contested election (i.e., if there are more nominees than director seats available).

Beneficial ownership and “affiliate” status.
The rules will also amend Exchange Act Rules 13d-1(b)(1)(i) and (c)(1) to clarify that a shareholder or group will not lose Schedule 13G eligibility by virtue of engaging in “activities solely in connection with a nomination under” Rule 14a-11. The final rules do not, however, exempt members of a nominating shareholder group from obligations to aggregate their shareholdings and, if required, file under Exchange Act Section 13(d) or Exchange Act Section 16, if they have formed a “group” for purposes of those sections. In addition, the rules do not provide a safe harbor from affiliate status.

Changes to the “Election Exclusion” in Rule 14a-8
The SEC amended Rule 14a-8 in a manner designed to allow a shareholder to include its own “proxy access” proposal in the company’s proxy statement so long as the proposal does not limit the availability of Rule 14a-11. Specifically, the new rules amend Rule 14a-8(i)(8) by repealing the exclusion that allowed a company to exclude proposals that “relate to a nomination or an election” or “a procedure” for a nomination or election. Pursuant to the amended Rule 14a-8, a company may exclude proposals relating to the election of directors based only on one of the following enumerated conditions:

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

The adopting release makes clear that a shareholder proposal submitted under Rule 14a-8 that prevents a shareholder from nominating a director under Rule 14a-11 by, for example, including a higher ownership threshold or longer holding period, will not be permitted. However, proposals that provide additional means for a shareholder to nominate a director (by providing a lower threshold for example), on the other hand, will be permitted.

In the event of a shareholder nomination for inclusion in a company’s proxy statement other than pursuant to Rule 14a-11 (e.g., pursuant to a more lenient regime established by the company on its own or pursuant to a prior shareholder proposal), generally speaking, the shareholder will be required to submit notice to the company with certain of the disclosures required on Schedule 14N by the date specified in the company’s advance notice provisions, or where no provision is in place, no later than 120 calendar days before the date the company mailed its proxy materials for the prior year’s annual meeting. Note that this applies only to non-Rule 14a-11 nominations where the shareholder seeks to include a
nominee in the company’s proxy materials and not to a conventional proxy contest where the shareholder disseminates its own proxy statement.

A copy of the SEC’s adopting release, “Facilitating Shareholder Director Nominations,” is available here.

If you would like to discuss these matters, please contact any of us or your regular Davis Polk lawyer.

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