

PROXY ACCESS

Now that the SEC's rules on proxy access have been adopted, companies should take steps to prepare for the possibility of shareholders using the company's proxy materials to nominate directors in opposition to the board's nominees.



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The recently adopted SEC rules on proxy access establish a uniform, federally-mandated procedure to allow shareholders to use a company's proxy materials to nominate a short slate of directors in opposition to the board's nominees.

Similar to the SEC's procedures governing the inclusion of shareholder proposals in annual meeting proxies, these new rules set shareholder eligibility requirements, review procedures and deadlines and disclosure requirements. Companies will be required to include in their proxy materials up to a maximum number of eligible shareholder nominees and may not opt out of the new proxy access process by adopting more restrictive procedures.

The final rules, adopted on August 25, 2010, were approved by a 3-2 vote along party lines, and represent the culmination of many years of debate and multiple SEC rule proposals dating back to 2003.

This article explains:

- The scope and timing of the rules.
- The key requirements of the rules.
- Steps companies should take to prepare.

SCOPE AND TIMING

The effective date of the rules is November 15, 2010. Generally, the rules will apply to the 2011 proxy season for any company that had a 2010 proxy mailing date of March 15, 2010 or later.

The rules apply to US public companies, including voluntary filers and controlled companies. However:

- Smaller reporting companies (generally, companies with less than \$75 million of public float) do not have to comply with the requirements for three years from the effective date.
- Companies that are subject to the SEC's proxy requirements solely because they have a class of debt securities registered under Section 12 of the Exchange Act and foreign private issuers will **not** be subject to the new rules.

Notice of nominations must be filed 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. The rules will apply to the 2011 proxy season for any companies whose 120–150 day window period for notice of nominations is open after the effective date of the new rules.

In practice, we do not expect the new rules to have a major impact for the 2011 proxy season. Long-term institutional investors, for whom the rules were designed, are likely to exercise caution in using proxy access, at least in the early stages. These shareholders must be careful not to exhibit a desire to effect a change of control at the company (as this would render them ineligible to use the SEC's proxy access process), and many of them may be concerned about damaging their relationship with company management.

The most likely initial targets of proxy access will be those companies that suffer from long-term, systemic or particularly egregious failures to meet shareholder demands, whether on corporate governance issues or broader issues of shareholder value.

The new proxy access regime makes it even more important for companies to focus their efforts on shaping their strategies and communicating them to shareholders, and to do so well in advance of a “proxy access event.” At this stage companies should be reviewing their communication strategies and undertaking other related initiatives (see *Box, Preparing for the Changes*).

KEY REQUIREMENTS

The key requirements of the new proxy access rules relate to:

- Eligibility to nominate.
- Number and eligibility of nominees.
- Advance notice and other procedural requirements.

ELIGIBILITY TO NOMINATE

The rules establish access to proxy materials for shareholder nominees, but not the underlying right to nominate directors. The new procedures are not available if applicable state law or foreign law or the company’s governing documents prohibit shareholders from nominating director candidates. However, as the SEC notes in the adopting release, it is unaware of any state law that prohibits shareholders from nominating directors.

New SEC Rule 14a-11 allows a shareholder or group of shareholders to nominate directors using a company’s proxy materials only if the shareholder or group:

- Holds at least 3% of the total voting power of the company’s shares entitled to vote on the election of directors.
- Has held those shares continuously for a period of three years before the date of the notice of nomination and will continue to hold those shares through the date of the annual meeting.

Shareholders may aggregate their share holdings to meet these ownership requirements and, subject to certain filing and other conditions, may solicit other shareholders for this purpose. Importantly, the new proxy access procedures are not available to any shareholder or group seeking to change control of a company or seeking a greater number of board seats than are permitted under the new procedures.

PRACTICE NOTES

DOCUMENTS

CLAUSES

CHECKLISTS

ARTICLES

The following related Practice Notes can be found on practicallaw.com

>> **Simply search the title OR resource number**

[Preparing for the Annual Meeting or 6-502-0047](#)

[Conducting the Annual Meeting or 3-502-0058](#)

[Proxy Statements or 4-381-1684](#)

[What’s Market: Stockholder Proposals or 1-502-0846](#)

In a departure from the established SEC concept of “beneficial ownership,” the new proxy access rules look to the total voting power “held” by a shareholder, which includes only those shares for which the shareholder holds both:

- Voting power (the power to vote or direct the voting).
- Investment power (the power to dispose or direct the disposition).

For example, unlike Exchange Act Section 13(d) requirements, shares held do not include those that a nominating shareholder merely has the right to acquire, such as securities underlying options that are currently exercisable. There are no limits on resubmission year-over-year, although shareholders may only use the SEC’s proxy access procedures once each proxy cycle.

SHAREHOLDER NOMINEES

Shareholder nominations will not be accepted on a first-come, first-served basis (as had been proposed), but rather by the percentage of voting power held by the nominating shareholders, starting with the largest shareholder or group and continuing down the chain until the maximum allotment of shareholder nominees is reached. The number of shareholder nominees that must be included in a company’s proxy materials is capped at the greater of one nominee or 25% of the total number of board members (rounded down).

Shareholder nominees must meet the general standards of independence imposed by applicable stock exchange rules, but not the heightened standards that apply to audit committee members and that will soon apply to compensation committee members under

PREPARING FOR THE CHANGES

The following are some of the steps companies should be considering now in preparation for the proxy access rule changes.

IDENTIFY A RESPONSE TEAM

Timing of the proxy access process is tight. Companies should therefore establish a clear process to receive and consider nominations. Companies should also identify a response team (including appropriate members of management, investor relations, public relations and the nominating committee of the board and counsel), so that corporate action is coordinated and timely. The response team should familiarize themselves with the rules and set up responsibilities to address proxy access nominations, such as a nominee vetting team, shareholder relations team, legal process team and so on.

IDENTIFY SIGNIFICANT SHAREHOLDERS

Companies should work with their proxy solicitor to identify the most significant shareholders and understand their concerns. This will enhance the company's ability to identify likely shareholder groups and assess the shareholder base for Rule 14a-11 eligibility.

REVIEW HOT BUTTON ISSUES

Companies should identify and address preemptively hot button issues related to governance or other matters. This includes understanding the positions

taken by proxy advisory firms on these matters given that these firms have an increasing influence on shareholder votes.

REVIEW CERTIFICATE OF INCORPORATION AND BY-LAWS

Many companies require advance notice for shareholder nominations to be presented at annual and special meetings. These advance notice provisions should be reviewed and may need to be modified to account for the SEC's proxy access requirements.

Many companies will likely adopt "savings clauses" providing that any shareholder nominations that comply with the SEC's proxy access rules and are included in the company's proxy materials will be deemed to have satisfied the company's advance notice by-law.

Advance notice requirements with respect to director nominations outside of the SEC's proxy access procedures would not be affected by the SEC's prohibition against more restrictive requirements and therefore should be maintained as is.

REVIEW DIRECTOR QUALIFICATION REQUIREMENTS

Companies should review their director qualification requirements to determine which qualities are integral to a properly functioning board. This will allow them to respond to any shareholder nominees' candidacy quickly and appropriately.

the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Nominees need not meet any additional independence standards adopted by the company or any subjective independence standards imposed by the stock exchanges.

To avoid any "white knight" nominations or other opportunities for gaming between the company and friendly shareholders, with limited exceptions, there must be no relationship or agreement regarding the director nomination between the nominees (or any nominating shareholder) and the company.

There are no restrictions on the relationships between shareholder nominees and the nominating shareholders. However, if elected, all directors are

subject to state fiduciary duty requirements, which generally require that they act in the company's and all shareholders' interests and not merely in the interests of any specific shareholder or shareholder group.

PROCEDURAL REQUIREMENTS

The new proxy access rules include detailed notice, procedural and disclosure requirements. Some of the key provisions include:

- **Advance notice.** Advance notice of nomination on a new Schedule 14N must be filed with the SEC and provided to the company by the nominating shareholder during a window period that is 120 to 150 calendar days before

In addition, companies may consider disclosing these qualifications more clearly in their by-laws so that shareholders will be on notice as to those qualifications. While director qualification by-laws will not prevent shareholder nominees from being included in a company's proxy materials under Rule 14a-11, nominating shareholders must disclose whether their shareholder nominees meet these requirements in the new Schedule 14N. Companies are free to address any deficiencies in their statements in opposition to the nominees.

It remains an open question whether a company may or should prevent the seating on the board of a shareholder nominee who does not meet the company's director qualifications requirements.

REVIEW MAJORITY VOTING ELECTION STANDARD (IF APPLICABLE)

Companies should review their director election standards to see how they would apply if there are shareholder nominees. Most majority voting standards do not apply to a "contested election," which is often defined as a director election where the number of director nominees exceeds the number of available seats.

REVIEW PROXY SCHEDULE

Companies should review their proxy printing, filing and mailing schedules to see how they would

work with the new proxy access regime. The proxy access response team and the regular proxy review team should develop a single coordinated process and timetable that brings together applicable federal, state and securities exchange timing and notice requirements as well as the company's own internal vetting timing and notice requirements. The deadlines for dispute resolution with respect to the inclusion or exclusion of shareholder nominees is very tight, especially in light of the requirement that companies must continue to add shareholder nominees up until the time of printing.

EVALUATE CORPORATE GOVERNANCE DOCUMENTS

In addition to the proxy access changes, further changes will likely apply to the 2011 proxy season as a result of the enactment of the Dodd-Frank Act, including the advent of mandatory say-on-pay for US companies. Companies should begin to evaluate their corporate governance documents and proxy vetting and filing procedures and timing to account for these new requirements as well.

>> For more on the corporate governance aspects of the Dodd-Frank Act, search [Summary of the Dodd-Frank Act: Corporate Governance](#) on our website.

the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting.

- **Disclosure requirements.** Schedule 14N requires, among other things:
 - certifications that the nominating shareholders and nominees meet eligibility requirements;
 - information similar to that currently required for election contests under SEC rules;
 - information regarding certain relationships (such as agreements or litigation) between the nominating shareholders or nominees and the company or its affiliates;

- information as to whether any nominating shareholder has been involved in certain legal proceedings during the past ten years; and
- the nominating shareholders' statement in support of their nominees (not to exceed 500 words per nominee).

Shareholders are liable for all of the information included in Schedule 14N, regardless of whether that information is ultimately included in a company's proxy materials.

- **Additional soliciting materials.** Nominating shareholders may use soliciting materials outside of the company's proxy materials. However, additional soliciting materials used to seek support of their nominees or to oppose the

PRIVATE ORDERING

The final rules contemplate the private ordering of the proxy access process, allowing shareholders to propose amendments to a company's governing documents to provide for proxy access. However, shareholders may only submit proposals to adopt less restrictive ownership, holding period or other requirements than those established under the new rules.

This change has been given effect by amending Exchange Act Rule 14a-8(i)(8) to narrow the rule's election exclusion. This allows shareholders to propose amendments to a company's governing documents to provide for proxy access, so long as those amendments do not limit the availability of Rule 14a-11. As amended, the rule only allows companies to exclude shareholder proposals that seek to achieve one of the following:

- 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.
- Include a specific individual in the company's proxy materials for election to the board.
- Affect the outcome of the upcoming election of directors in any other way.

The final rules also contemplate that state or foreign law or a company's governing documents may establish alternative proxy access procedures. They set forth filing and disclosure requirements with respect to the inclusion in company proxy materials of shareholder nominations made according to these procedures. As with proxy access shareholder proposals, these alternative procedures may not be more restrictive than the SEC's proxy access rules.

company's nominees are subject to certain legending, disclosure and filing requirements. Nominating shareholders may not under any circumstances seek proxy power or otherwise request a form of revocation, abstention, consent or authorization with respect to the director election.

- **Excluding shareholder nominees.** If a company believes that shareholder nominees may be excluded from its proxy materials, it must notify the shareholders and the shareholders may respond to such exclusion determination (generally a 14-day deadline applies in each case). No later than 80 calendar days before the filing of definitive proxy materials with the SEC, the company must notify the SEC of a determination to exclude a shareholder nominee. Concurrently, the company may seek no-action relief regarding its exclusion determination from the SEC staff.
- **Withdrawal of shareholder nominees.** If a nominating shareholder or shareholder nominee withdraws or is disqualified, companies must continue to add other qualifying shareholder nominees up to the maximum allotment until the printing of proxy materials commences.
- **Company disclosure requirements.** If shareholder nominees are included in a company's proxy

materials, certain disclosure requirements apply. The company is not liable for any information provided by the nominating shareholders included in its proxy materials, regardless of whether the company has reason to know that such information is inaccurate. However, unlike with shareholder proposals, the existence of materially misleading or false information in the nominating shareholders' Schedule 14N (and subsequently in the company's proxy materials, such as the statement of support) is not a basis for exclusion of the shareholder nominees. Instead, companies may only address those concerns through their own proxy disclosure and related soliciting materials.