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U.S. SEC ADOPTS FINAL RULES ON PROXY ACCESS

To Our Clients and Friends:

Today the U.S. Securities and Exchange Commission ("SEC") adopted amendments to its proxy rules to permit shareholders to nominate directors in a company's proxy materials--commonly referred to as "proxy access." The vote on the amendments was 3-2, with Commissioners Casey and Paredes dissenting due to numerous concerns, including that the proxy access rules encroach on state corporate law and interfere with private ordering by companies and their shareholders.

The SEC previously proposed amendments to the federal proxy rules regarding proxy access in 2003 and 2007. The rules adopted today are based on those proposed on June 10, 2009. More recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Section 14(a) of the Securities Exchange Act of 1934 to authorize, but not require, the SEC to issue rules regarding the inclusion of shareholder nominees in a company's proxy materials.

The SEC's final release adopting the proxy access rules, which totals 451 pages, is available [here](#). We will issue an additional memorandum upon further analysis of the adopting release. The final rules take effect sixty days after publication in the Federal Register, except for smaller reporting companies (as defined in Rule 12b-2, generally companies with a public float of less than \$75 million), as described below. Thus, proxy access will be in effect in time for the 2011 proxy season for most calendar year issuers.

Overview of the Final Proxy Access Rules

There are two components to the proxy access rules approved by the SEC today: (1) establishing a federal proxy access right pursuant to Rule 14a-11 and related amendments, and (2) amending Rule 14a-8 to permit shareholder proposals that would establish additional, more flexible proxy access procedures.

Federal Proxy Access Right Created by Rule 14a-11

Rule 14a-11 creates a federal law process for a shareholder or group of shareholders to nominate one or more directors and have those nominees included in a company's proxy materials if certain requirements are satisfied. Rule 14a-11 will not apply where applicable state or foreign law or a company's governing documents (*e.g.*, charter, bylaws, certificate of designations, etc.) prohibit the company's shareholders from nominating directors.

- *Companies Subject to Proxy Access:*
 - Rule 14a-11 will apply to companies (including investment companies and controlled companies) subject to the Exchange Act proxy rules other than companies subject to such rules solely because they have debt securities registered under Section 12 of the Exchange Act. In addition, Rule 14a-11 will

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apply to companies that voluntarily register a class of securities under Section 12(g). Rule 14a-11 will not apply to foreign private issuers.

- Unlike previously proposed proxy access rules, companies will be subject to Rule 14a-11 regardless of any "triggers" that may demonstrate an objective need for proxy access.
- Companies cannot "opt out" of being subject to Rule 14a-11: the proxy access right will apply regardless of whether a company has a provision in its governing documents providing for or prohibiting the inclusion of shareholder nominees in its proxy materials. The only exception to Rule 14a-11's applicability is if state or foreign law or a company's governing documents prohibit shareholders from nominating directors.
- *Ownership Requirement:*
 - To be eligible to use the Rule 14a-11 process, shareholders must own at least three percent of the total voting power of the company's securities entitled to vote on the election of directors at the annual meeting. The rules contain detailed instructions on how to calculate ownership.
 - Shareholders may aggregate their securities with other shareholders in order to meet the three percent threshold. However, only shares over which the shareholder has investment and voting control will be counted toward the three percent threshold--borrowed shares will be excluded. Securities that have been loaned to a third party by a nominating shareholder may be counted toward the ownership threshold if the nominating shareholder has the right to recall the securities and will recall the loaned securities upon notification that the shareholder's nominee will be included in the company's proxy materials.
 - Shareholders must have held their shares for at least three years, must provide a statement that they intend to continue to own at least the required amount of securities through the date of the meeting at which directors are elected and must disclose their intent regarding continued ownership of the securities after the election.
 - Shareholders who hold the securities for the purpose of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees a company could be required to include under new Rule 14a-11 are not eligible to nominate directors under Rule 14a-11.
- *Other Eligibility Requirements:*
 - The director nominee's candidacy and, if elected, service on the board must not violate federal, state or foreign law, or the rules of a national securities exchange, if applicable, and the nominee must satisfy the objective independence standards of the applicable national securities exchange.[1]

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- Additionally, neither the nominee nor the nominating shareholder (including any member of the nominating shareholder group) may have any direct or indirect agreement with the company regarding the nomination. Notably, Rule 14a-11 does not restrict the ability of shareholders to nominate directors with whom they have a relationship.
- *Notice Requirements:* If a shareholder seeks to nominate one or more director candidates, the nominating shareholder must file a new Schedule 14N with the SEC and provide a copy to the company, no later than 120 days before the anniversary of the mailing date for the company's definitive proxy statement in the previous year. Schedule 14N, which will be publicly available when filed, requires any nominating shareholders to make certain disclosures, including reporting:
 - the name and address of the nominating shareholder or each member of the nominating shareholder group;
 - the amount and percentage of the company's shares held and entitled to vote in the director election and related ownership information;
 - that the shares used to satisfy the ownership threshold have been held continuously for at least three years;
 - that the nominating shareholder or each member of the nominating shareholder group intends to hold their shares through the date of the meeting;
 - the intent of the nominating shareholder or each member of the nominating shareholder group with respect to continued ownership after the election;
 - any relationship between the nominating shareholder or group and nominee or nominees and the company;
 - biographical information about the nominating shareholder or each member of the nominating shareholder group and the nominee or nominees;
 - a statement that, to the best of the nominating shareholder's or group's knowledge, the nominee meets the objective criteria for "independence" under applicable stock exchange rule, and a statement of whether, to the best of the nominating shareholder's or group's knowledge, the nominee meets the director qualifications, if any, set forth in the company's governing documents;
 - disclosure of any legal proceeding that the nominating shareholder or member of the nominating shareholder group has been involved in during the past ten years;
 - a representation that the nominee's candidacy and, if elected, service would not violate controlling state, federal or foreign law, or rules of a national securities exchange or national securities association, and otherwise would satisfy the eligibility requirements of Rule 14a-11;

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- a statement in support of the nominee or nominees not exceeding 500 words per nominee, if the nominating shareholder or group elects to include such a statement included in the company's proxy statement; and
- a certification by the nominating shareholder or group that the nomination is not intended either to result in a change in control of the company or to gain more than the maximum number of board seats permitted under Rule 14a-11.
- *Number of Directors:* Shareholders may include in a company's proxy materials the greater of one director nominee or a number of director nominees that equals up to twenty-five percent of the company's board, which number may be rounded down. If the number of nominees submitted exceeds the authorized number of permissible nominees under Rule 14a-11, then priority is given to the nominees from the nominating shareholder or shareholder group holding the greatest percentage of securities eligible to vote in the election of directors. If a company agrees to nominate a candidate who is proposed by a shareholder under Rule 14a-11, the candidate will count against the twenty-five percent limit. For companies with classified boards, this limit is calculated based on the total number of directors on the board even though only one-third of the directors may be up for election at the meeting.
- *Deadlines under Rule 14a-11:* Shareholders seeking to submit a director nominee under Rule 14a-11 and the companies subject to Rule 14a-11 must follow the following timeline, which is similar to the timeline for shareholder proposals submitted under Rule 14a-8:
 - Shareholders must file Schedule 14N with the SEC and provide a copy to the company no earlier than 150 days and no later than 120 days before the anniversary of the mailing of the company's proxy statement in the previous year.
 - If a company determines to include the shareholder nominee in its proxy materials, it must notify the nominating shareholder or group no later than thirty days before the company files its definitive proxy statement with the SEC.
 - If the company seeks to exclude the shareholder nominee from its proxy materials, the company must provide notice to the shareholder no later than fourteen days after the applicable deadline for transmitting a Schedule 14N for such annual meeting.
 - The nominating shareholder then will have fourteen days after receipt of the notice by the company to respond and correct any eligibility or procedural deficiencies identified in the notice.
 - If the company continues to believe that it has a basis for not including the nominee in its proxy materials, the company must provide notice of the basis for its exclusion to the SEC no less than eighty days before it files its definitive proxy statement with the SEC. The company also may request that the SEC staff issue a no-action letter concurring that the company may exclude the director nominee or the statement in support of such nominee.

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- *Liability:* The nominating shareholder or group will be liable for any statement in Schedule 14N or any other related communication that is false or misleading with respect to any material fact, or that omits to state any material fact necessary to make the statements not false or misleading, regardless of whether that information is ultimately included in the company's proxy statement. Companies will not be liable for information provided by the nominating shareholder or group under Rule 14a-11 that the company then includes in its proxy statement except to the extent that the company subsequently specifically incorporates the information by reference or "otherwise adopt[s] the information as its own."
- *Amendments to Related SEC Rules:* The SEC also amended the following related rules:
 - Nominating shareholder groups may report their aggregate ownership on Schedule 13G, rather than Schedule 13D, if the group was formed solely for the purpose of nominating director(s) pursuant to Rule 14a-11. In providing this exception, the SEC noted that the more burdensome Schedule 13D disclosure requirements could deter some shareholders from forming such nominating groups.
 - The exception, however, is unavailable to nominating shareholders or groups that either: (i) engage in activities beyond nominating directors, soliciting proxies for their director nominees, or against a company's nominees in accordance with Rule 14a-11, or (ii) otherwise submit a nomination pursuant to a company's governing documents or applicable state or foreign law provisions.
 - Nominating shareholders or groups submitting a nomination pursuant to a company's governing documents or applicable state or foreign law provisions will not be eligible for the exception to reporting on Schedule 13D.
 - The SEC did not exempt nominating shareholders and groups from the applicability of Section 16. The SEC noted that groups could form in order to nominate directors without crossing the ten percent threshold that triggers Section 16 reporting and short swing profit recovery provisions. Shareholder groups with greater than ten percent beneficial ownership will continue to be analyzed under Section 16 in the same way as groups formed for any other purpose. Likewise, nominating shareholders and groups are not exempted from the operation of the Securities Act of 1933 standards for affiliates.
 - Written and oral communications made pursuant to Rule 14a-11, which would be deemed solicitations under the SEC proxy rules, will be exempt from certain disclosure, filing, and other requirements of those rules, so long as the shareholder is not holding the company's securities with the purpose or effect of changing control of the company.
 - Rule 14a-2(b)(7) generally will exempt shareholder solicitations in connection with efforts to form a nominating group and Rule 14a-2(b)(8) generally will exempt shareholder solicitations made in support of the group's nominee(s) and/or against the company's nominees. Solicitations

made pursuant to either rule will need to be reported on Schedule 14N no later than the date of first use. Solicitations made pursuant to Rule 14a-2(b)(8) may commence once the nominating shareholder or group receives notice from the company that the shareholder nominee will be included in the company's proxy materials.

- Written solicitations to form a nominating group, in support of the shareholder's nominee(s) and/or against the company's nominees nevertheless will need to be filed with the SEC under cover of Schedule 14N and will be subject to certain content requirements. Written group solicitations may only include certain information (*e.g.*, the shareholder's intent to form a group, the shareholder's voting power, the means by which the shareholder may be contacted, and a brief statement about the identity and characteristics of the nominee). Written support solicitations must include the identity of the nominating shareholder or group and their interests in the company, as well as a legend indicating that the nominee will be included in the company's proxy materials, which shareholders can access on the SEC website. Oral solicitations will not be subject to content requirements, but will need to be reported on Schedule 14N.
- If a nominating shareholder or group subsequently engages in a non-Rule 14a-11 solicitation or nomination, their exemption under either rule would be lost.

Amendment to Rule 14a-8(i)(8) on Proxy Access Shareholder Proposals

Rule 14a-8(i)(8) currently permits companies to exclude proxy access shareholder proposals. Pursuant to the amendment to Rule 14a-8(i)(8) adopted today, companies will not be able to exclude a proxy access shareholder proposal under Rule 14a-8(i)(8) solely because it relates to proxy access but can exclude a proxy access shareholder proposal if it conflicts with state law or Rule 14a-11. A shareholder proposal could expand proxy access to a broader group of shareholders or create alternative proxy access rights, but could not have the effect of preventing a shareholder or group that satisfies the requirements of Rule 14a-11 from having its nominee included in a company's proxy materials. For example, a shareholder proposal could not simply propose higher ownership thresholds than those found in Rule 14a-11. In the context of any alternative access mechanism established under Rule 14a-8(i)(8), the amended rules also change a number of other proxy rules in a manner that is generally consistent with Rule 14a-11 and new Schedule 14N.

The current eligibility provisions of Rule 14a-8 remain unchanged, requiring that a shareholder proponent have continuously held at least \$2,000 in market value (or one percent, whichever is less) of the company's securities entitled to be voted on the proposal at the meeting, for a period of at least one year prior to submitting the proposal.

Effective Date

These proxy access rules will become effective sixty days after publication in the Federal Register. Because shareholders seeking to submit a director nominee under Rule 14a-11 must do

GIBSON DUNN

so no later than 120 days before the anniversary of the mailing of the company's proxy statement in the previous year, if the rules are published in the Federal Register on September 2, they would become effective on November 1, and shareholders at companies that mailed their proxy statement on or after March 1, 2010 could nominate directors under the requirements of Rule 14a-11.

However, the effective date of Rule 14a-11--but not the amendments to Rule 14a-8(i)(8)--for smaller reporting companies is three years from the rule's effective date. This delayed effective date is intended to give the SEC time to make any adjustments it deems appropriate, after study, for smaller companies and to allow smaller companies time to prepare for the implementation of Rule 14a-11. However, this deferral does not apply to the Rule 14a-8 amendment. Thus, during that deferral period a smaller reporting company still could be subject to proxy access through shareholder approval of a binding proxy access bylaw amendment submitted under Rule 14a-8(i)(8).

[1] Note that this memorandum does not address rules applicable to investment companies.



Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you work, or any of the following:

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