

AUGUST 25, 2010

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## SEC Adopts Final Proxy Access Rules

On August 25, the SEC adopted final “proxy access” rules by a 3-2 vote. Subject to conditions, the new rules provide sizeable, long-term and non-control shareholders with direct access to the proxy statements of public companies for the purpose of nominating and soliciting support for a limited number of director nominees.<sup>1</sup> The rules will be effective 60 days after publication in the Federal Register.

The gestation period for the new rules has been long and contentious, and the remarks of the Commissioners at the open meeting reflected the continued strongly held and divergent views about the question. The remarks of Commissioners Casey and Paredes, in particular, seemed to map out what are, at least in their minds, possible grounds to challenge the rules on the grounds that the process followed by the SEC in adopting the rules was arbitrary and capricious.

In a more conciliatory approach, Chairman Schapiro emphasized that the final rules “reflect compromise and weighing competing interests.” A key compromise is the eligibility standard applicable to nominating shareholders. The centerpiece of the regime – new Rule 14a-11 – requires a nominating shareholder or group to have owned both an investment and voting interest (excluding borrowed shares and shares sold short) representing at least 3% of the company’s voting power, continuously for three years and through the election. On the other hand, the SEC determined not to permit shareholders the ability to “opt out” of the Rule 14a-11 proxy access regime, as advocated by the business community.

The rules apply to all companies subject to the SEC proxy rules – *i.e.*, all SEC reporting companies (including investment companies and controlled companies), other than foreign private issuers (which are not subject to the proxy rules) and debt-only registrants. The applicability of the rules to “smaller reporting companies” will be delayed for three years.

Whether nominations may be made for a particular company’s annual meeting in 2011 depends on two variables: the Federal Register publication date and the mailing date for the company’s 2010 proxy statement. Notice of nominations to a company must be

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<sup>1</sup> SEC Rel. Nos. 33-9136; 34-62764; IC-29384 (Aug. 25, 2010). The text of the releases adopting the rules is available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

provided no earlier than 150 days, and no later than 120 days, before the anniversary of the mailing of that company's proxy statement for the prior year's annual meeting.

We summarize below the main points of the new regime and expect to publish in the near future a more detailed analysis of their operation and the practical implementation issues they will raise.

#### Subject Companies; No Opt Out

- The rules apply to all companies subject to the SEC proxy rules – *i.e.*, all Exchange Act reporting companies (including investment companies and controlled companies) other than foreign private issuers (which are not subject to the proxy rules) and debt-only registrants. Non-U.S. companies that report on U.S. forms are therefore also subject to the rules.
- Applicability of the rules to “smaller reporting companies” (generally, those with a public float of less than \$75 million, excluding investment companies) will be delayed for three years.
- The rules do not permit companies to “opt out” of the Rule 14a-11 proxy access regime.

#### Required Ownership and Holding Period

- Nominations may be made only by a shareholder or group that owns (as described below), as of the date of its nominating notice, at least 3% of the voting power of the company's securities that are entitled to be voted on the election of directors. Ownership of group members may be aggregated to reach this threshold.
- The nominating shareholder (or each member of the group) must have held the requisite amount of securities continuously for at least three years as of the date of the nominating notice. In a change from the proposal, the nominating shareholder or group also must continue to hold the requisite amount of securities through the date of the election of directors, and must disclose its intent with respect to continued ownership after the election.
- The nominating shareholder must hold, either directly or through those acting on its behalf, both the power to dispose of and the power to vote the securities counted toward the threshold. Borrowed shares and shares sold short may not be counted. However, shares that the nominating shareholder has loaned to a third party may be counted, provided it has the right to recall the loaned shares and will do so if its nominee is to be included in the company's proxy materials.

### Control Intent

- To be eligible, a nominating shareholder (and each member of any group) must not hold any of the company's securities with the purpose or effect 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. In covering not just control intent, but also an intent to gain a number of board seats exceeding the maximum under the proxy access rules, the final rule goes beyond the proposal.

### Maximum Number of Nominees; Allocation Among Shareholders

- The maximum number of access nominees is 25% of the total number of board seats, or one director, whichever is greater.
- If a company has a classified board, the percentage will be calculated based on the total number of board seats, not the number of seats being voted on in a particular election. However, where the term of a director who was previously nominated pursuant to the proxy access rules continues past the meeting date (as in the case of a classified board), that director would count against the 25% maximum.
- If nominations from all eligible shareholders or groups exceed the maximum number of permitted access nominees, then the company must include the nominees of the nominating shareholder(s) or group(s) owning the largest percentage of qualifying voting power.
- If a nominating shareholder or group has made an eligible nomination before beginning any discussion with the company about the nomination and the company subsequently agrees to include the nominating shareholder's or group's nominees on the company's proxy card as company nominees, those nominees will count toward the 25% maximum.
- Incumbent directors who were originally nominated pursuant to the proxy access rules and who have been nominated for re-election by the company will not count toward the maximum number of directors.

### Effect of Concurrent Proxy Contest

- As in the proposal, there is no exception or other accommodation from the proxy access rules where the company is engaged in a concurrent traditional proxy contest.
- However, a shareholder relying on the proxy access rules will be subject to restrictions that generally limit its ability to solicit with respect to nominees advanced by another shareholder or group through a traditional proxy contest or to act as a "participant" in the proxy contest.

#### Timing of Nominations; Dispute Resolution

- An eligible shareholder or group must submit nominees, together with required disclosure regarding the nominating shareholder or group and nominee(s), no earlier than 150 days, and no later than 120 days, before the anniversary of the mailing of the prior year's proxy statement. The notice and disclosure must be filed with the SEC on Schedule 14N and provided to the company on the same day. Unlike the proposal, the final rules provide that the window for proxy access nominations is uniform and is not affected by any time period contained in a company's advance notice bylaw.
- The rules include a process for the company to seek no-action guidance from the SEC staff if the company believes it may exclude a nominee from its proxy materials. During the open meeting, the Director of the Division of Corporation Finance expressed her view that the Division staff is committed to handle no-action requests in a timely way and has the resources to do so.

#### Eligibility Criteria for Access Nominees; Required Disclosure

- Access nominees must meet the objective "independence" criteria of the applicable exchange, but need not be independent from the nominating shareholder.
- Neither a nominating shareholder nor any member of a nominating group may have any direct or indirect agreement with the company regarding the nomination of the nominee at the time of filing the Schedule 14N.
- The nominating shareholder must disclose whether, to the best of its knowledge, the nominee meets any other qualifications for directors set forth in the company's governing documents. However, the nominee need not meet those qualifications to be eligible.
- The nominating shareholder must disclose in Schedule 14N its ownership and voting interest in the company and length of ownership, its eligibility to use Rule 14a-11, the nature and extent of any relationships between the nominating shareholder, its nominees and/or the company, its involvement in legal proceedings, and other information about the nominating shareholder and its nominees as would be provided in response to Items 4(b), 5(b), 7(a), (b) and (c) and, for investment companies, Item 22(b) of Schedule 14A.

#### Limited Exemptions for Solicitations

- The rules provide an exemption from disclosure and other generally applicable requirements of the proxy rules for communications by any shareholder in connection with forming a nominating shareholder group, provided that the shareholder is not holding the company's securities with the purpose or effect of changing control of the

company or to gain a number of board seats exceeding the maximum number of Rule 14a-11 nominees and certain other conditions are met.

- In addition, the rules provide an exemption for solicitations by a nominating shareholder or group, provided certain conditions are met. The exemption begins to apply after the company notifies the nominating shareholder or group that its nominees will be included in the company's proxy materials.

#### Liability for Information Provided by Nominating Shareholder

- A nominating shareholder or group will have liability for any material misstatement or omission in the information provided to the company on Schedule 14N or in related communications, whether or not included in the company's proxy materials.
- A company is not responsible for information provided by the nominating shareholder or group and included in the company's proxy materials. This standard is more protective of companies than that included in the proposal. At the same time, however, companies may not omit information provided by a nominating shareholder from its proxy materials on the grounds that it is materially misleading.

#### Rule 14a-8 Proposals

- Rule 14a-8 is amended to enable shareholders to require a company to include in its annual proxy statement shareholder proposals advocating an amendment to the company's governing documents to provide a procedure for proxy access. No such procedure could, however, restrict the availability of the Rule 14a-11 proxy access regime. While a company could adopt a procedure that, for example, required a higher ownership threshold for nominating shareholders but allowed a larger number of nominees than Rule 14a-11, that procedure would not limit shareholders' ability to make nominations pursuant to Rule 14a-11 using its lower ownership threshold. Similarly, an advance notice bylaw stating (as many do) that compliance with the bylaw is the exclusive means by which shareholders may nominate director candidates does not limit the availability or impact the timing provisions of Rule 14a-11.
- To use an alternative proxy access procedure adopted by a company's shareholders, a nominating shareholder or group must provide disclosure generally mirroring that required under the Rule 14a-11 proxy access regime.

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For further information on this subject or if you have any questions, please contact any of your regular contacts at the firm or any of our partners and counsel listed under “Capital Markets,” “Corporate Governance” or “Mergers, Acquisitions and Joint Ventures” in the “Practices” section of our website ([www.clearygottlieb.com](http://www.clearygottlieb.com)).

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