

## **SEC Proposes Rule Amendments to Facilitate the Rights of Shareholders to Nominate Directors**

On May 20, 2009, the Securities and Exchange Commission (“SEC” or “Commission”), at an open meeting, voted to publish for comment a comprehensive series of amendments to the proxy rules under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).<sup>1</sup> The amendments, if adopted, would facilitate the rights of shareholders to nominate directors on corporate boards. Shareholders would also have the ability to use shareholder proposals to modify a company’s nomination procedures or disclosure about elections, so long as those proposals do not conflict with state law or SEC rules. The proposal comes after the newly appointed SEC Chairman Mary J. Schapiro directed the Commission’s Staff to draft proposals for rules governing shareholder proxy access.<sup>2</sup>

The proposal was approved by a 3-2 vote of the Commission. Chairman Schapiro and Commissioners Elisse Walter and Luis Aguilar voted in favor of the proposal, while Commissioners Kathleen Casey and Troy Paredes voted against it.<sup>3</sup> The full text of the proposals has not yet been made available. Set forth below is a summary of the proposed amendments, based upon statements made at the SEC’s May 20, 2009 meeting and documents made available in connection therewith.<sup>4</sup>

### **I. Background**

In recent years, the Commission has discussed, but has not gone forward with, proposed rules that would provide shareholders with access to companies’ proxy statements for the purpose of nominating their own director candidates.<sup>5</sup> In 2007, the SEC codified an exclusion from Rule 14a-8 that made it clear that a proxy access bylaw could be excluded by a company from its proxy statement.<sup>6</sup>

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<sup>1</sup> See Speech by SEC Chairman: Opening Remarks at the SEC Open Meeting by Chairman Mary L. Schapiro, U.S. Securities Exchange Commission, Washington, D.C. May 20, 2009, <http://www.sec.gov/news/speech/2009/spch051409mls.htm>. Video footage of the open meeting is archived at <http://www.sec.gov/news/speech.shtml>.

<sup>2</sup> In an April 6, 2009 speech at the “Council of Institutional Investors – Spring 2009 Meeting”, Chairman Schapiro previewed a number of regulatory reform initiatives that the SEC will consider in upcoming months. The complete text of Chairman Schapiro’s speech is available at: <http://www.sec.gov/news/speech/2009/spch040609mls.htm>.

<sup>3</sup> Commissioners Casey and Paredes objected to the proposals based on the belief that the proposal inappropriately infringed upon the states’ rights to establish their respective corporate governance laws.

<sup>4</sup> Release No. 2009-116, U.S. Securities and Exchange Commission, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors (May 20, 2009), available at <http://www.sec.gov/news/press/2009/2009-116.htm>.

<sup>5</sup> Release No. 34-48626, available at [www.sec.gov/rules/34-48626.htm](http://www.sec.gov/rules/34-48626.htm). See Shareholder Proposals, Release No. 34-56160 (July 27, 2007) (with respect to the proposed shareholder access rules); Shareholder Proposals Relating to the Election of Directors, Release No. 34-56161 (July 27, 2007) (with respect to the proposal to codify the Staff’s existing interpretation).

<sup>6</sup> See Release No. 34-56914, “Shareholder Proposals Relating the Election of Directors,” available at <http://sec.gov/rules/final/2007/34-56914.pdf>.

## II. Related State and Federal Law Developments

During the past two years, the states of Delaware and North Dakota adopted comprehensive packages of shareholder-friendly changes to their respective state corporate laws. In addition, legislation to enhance shareholder rights has been proposed in the U.S. Senate.

### *Delaware*

The Delaware General Assembly enacted amendments to the Delaware General Corporations Law with respect to proxy access and expense reimbursement for director-election contests.<sup>7</sup> The amendments, enacted in April and effective August 1, include a provision that a company's bylaws may require the company to include in its proxy solicitation materials shareholder-nominated candidates for the board of directors.<sup>8</sup> The amendments state that the bylaws may provide procedures for or conditions to proxy access, including:

- Requiring a minimum level of beneficial ownership (which may be defined to include options and similar rights) by the nominating shareholder,
- Requiring a minimum duration of ownership by the nominating shareholder,
- Requiring the submission of specific details regarding the nominating shareholder and nominee(s) (not limited to the amount of ownership interest),
- Limiting the number or proportion of directors that may be nominated at a given time,
- Precluding the nomination of shareholders and nominees who have acquired or proposed to acquire a specific percentage of voting power before the election, and
- Requiring indemnification of the company for any loss relating to false or misleading information submitted in connection with the nomination.

The amendments also provide that a company's bylaws may provide for the reimbursement by the company of a shareholder's expenses incurred in soliciting proxies in connection with the election of directors.<sup>9</sup> The bylaws may provide procedures for or conditions to reimbursement, including:

- eligibility requirements based on the number or proportion of directors nominated by the shareholder seeking reimbursement or whether the shareholder previously sought reimbursement,
- provisions tying the amount of reimbursement to the proportion of votes cast in favor of one or more of the shareholder's nominees, or to the amount spent by the company in soliciting proxies, and
- limitations concerning cumulative voting.

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<sup>7</sup> For a more detailed discussion of the Delaware law regarding proxy solicitations, see *New Delaware Law Regarding Proxy Solicitations Involving Contested Director Elections* (April 21, 2009), available at <http://www.cahill.com/news/memoranda/000161>.

<sup>8</sup> H.B. 19, 145th Gen. Assem. ("H.B. 19"), § 1 (Del. 2009) (to be codified at Del. Code Ann. tit. 8, § 112).

<sup>9</sup> H.B. 19 § 2 (to be codified at Del. Code Ann. tit. 8, § 113).

## *North Dakota*

In 2007, North Dakota mandated, for publicly traded companies, proxy access by statute (in contrast with Delaware's permissive by-law approach).<sup>10</sup> The North Dakota statute provides that a shareholder or group owning 5% of the stock for a period of two years can include nominees in the company's proxy statement. Under the North Dakota statute, the company is limited in the information it can require from the shareholders and may not impose additional conditions and procedures on the shareholder.<sup>11</sup>

### *S. 1074: The Shareholder Bill of Rights*

On May 19, 2009, Senators Charles Schumer of New York and Maria Cantwell of Washington introduced sweeping legislation that, if enacted, would significantly change how corporate boards are elected and operated. The bill, the "Shareholder Bill of Rights Act of 2009," addresses virtually all of the major reforms sought by activist investors during the past decade, including proxy access, advisory votes on compensation, and independent board chairs.<sup>12</sup>

## **III. The SEC Proposed Rules**

### *Including Nominees in the Company's Proxy Materials*

Under proposed new Exchange Act Rule 14a-11, shareholders could, under certain circumstances, include a nominee or nominees for director in company proxy materials unless the shareholders are otherwise prohibited by state law or a company's governing documents from nominating a candidate for election as a director.<sup>13</sup>

The proposed rule would apply to all Exchange Act reporting companies, including investment companies, other than foreign private issuers and companies that report solely because they have publicly issued debt securities.

Shareholders would be eligible to have their nominee included in the proxy materials if:

- They own at least 1 percent of the voting securities of a "large accelerated filer" (a company with a worldwide market value of \$700 million or more) or of a registered investment company with net assets of \$700 million or more.
- They own at least 3 percent of the voting securities of an "accelerated filer" (a company with a worldwide market value of \$75 million or more but less than \$700 million), or of a registered investment company with net assets of \$75 million or more but less than \$700 million.

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<sup>10</sup> Only two publicly traded companies are incorporated in North Dakota. See Cari Tuna, *Shareholders Ponder North Dakota Law*, Wall St. J., Dec. 8, 2008, available at <http://online.wsj.com/article/SB122852051008284099.html>

<sup>11</sup> Chapter 10-35 of the North Dakota Century Code. The text of the law is available at <http://www.legis.nd.gov/assembly/60-2007/bill-index/bi1340.html>.

<sup>12</sup> S. 1074, titled "A bill to provide shareholders with enhanced authority over the nomination, election, and compensation of public company executives." The proposed legislation would also give shareholders an advisory vote on executive compensation packages, and would require that corporate boards establish risk committees. The text of the bill is not yet available on line.

<sup>13</sup> Note, however, that the proposed Exchange Act Rule 14a-11 would pre-empt any proxy access provision of state law or a company's organizational documents. Advance notice bylaws, however, would not be subject to pre-emption.

- They own at least 5 percent of the voting securities of a non-accelerated filer (a company with a worldwide market value of less than \$75 million) or of a registered investment company with net assets of less than \$75 million.<sup>14</sup>
- They have held their shares for at least one year.
- They sign a statement declaring their intent to continue to own their shares through the annual meeting at which directors are elected.
- They certify that they are not holding their stock for the purpose of changing control of the company, or to gain more than minority representation on the board of directors.

### ***Nominee Requirements***

A shareholder's nominee would be required to meet the following requirements:

- The nominee's candidacy or, if elected, board membership must not violate applicable laws and regulations.
- The nominee must satisfy objective independence standards of the applicable national securities exchange or national securities association.
- The nominating shareholder may have no direct or indirect agreement with the company regarding the nomination of the nominee.
- A shareholder or group may nominate no more than the greater of one nominee or a number of nominees that represents up to 25 percent of the company's board of directors. For example, if the board is comprised of three members, one shareholder nominee could be included in the proxy materials. If the board is comprised of eight members, up to two shareholder nominees could be included in the proxy materials.) At the May 20, 2009 meeting, the SEC Staff indicated that if one or more shareholders or groups sought to nominate a number of directors that, in the aggregate, would exceed this limit, the shareholder or group providing the earliest or earlier notice of their nomination would be given priority, as opposed to the shareholder or shareholder group with the largest voting interest.

### ***Nominating Shareholder and Nominee Disclosure Requirements***

- The nominating shareholder would be required to file with the SEC and submit to the company a newly proposed Schedule 14N. Schedule 14N would require disclosure of the amount and percentage of securities owned by the nominating shareholder, the length of ownership, and intent to continue to hold the securities through the date of the meeting. Schedule 14N would also require a certification that the nominating shareholder is not seeking to change the control of the company or to gain more than minority representation on the board of directors.
- The company would include in its proxy materials disclosure concerning the nominating shareholder, as well as the shareholder nominee or nominees, that is similar to the disclosure currently required in a contested election.

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<sup>14</sup> A group of shareholders would be able to aggregate holdings to meet the applicable thresholds. At the May 20, 2009 meeting, the SEC Staff indicated that being a group member for this purpose alone would not affect a shareholder's eligibility to file beneficial ownership reports on Schedule 13G as opposed to Schedule 13D.

## *Nominating Shareholder Liability*

- A nominating shareholder or group would be liable for any false or misleading statements in information provided to the company that is then included in the company's proxy materials.
- The company will not be responsible for information provided by the shareholder(s), unless the company knows or has reason to know the information is false.

## *Shareholder Proposals*

Under proposed amended Exchange Act Rule 14a-8(i)(8), shareholders could require companies, under certain circumstances, to include proposals in their proxy materials that would amend, or request an amendment to, the company's governing documents to address the company's nomination procedures or other director nomination disclosure provisions that do not conflict with SEC rules (which presumably would permit proxy access with less stringent conditions than those in the provided rule amendments, but not more stringent.)

Currently, Exchange Act Rule 14a-8(i)(8) permits companies to exclude shareholder proposals that "relate to an election." Under the new proposal, the "election exclusion" would be narrowed, thereby allowing in the proxy materials more shareholder proposals regarding elections. Specifically, shareholder proposals by qualified shareholder proponents that would amend, or that request an amendment to, provisions of a company's governing documents concerning the company's nomination procedures or other director nomination disclosure provisions (so long as those disclosure provisions do not conflict with proposed Rule 14a-11 above) would not be excludable.

A shareholder proponent would be qualified if the shareholder has continuously held at least \$2,000 in market value (or 1 percent, whichever is less) of the company's securities entitled to be voted on the proposal at the meeting, for a period of one year prior to submitting the proposal.

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The full text of the proposed rule amendments will be posted to the SEC Web site. Public comments on these proposed rule amendments must be received by the SEC within 60 days after their publication in the Federal Register.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Richard E. Farley at 212.701.3434 or [rfarley@cahill.com](mailto:rfarley@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); or John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).