August 25, 2010

SEC Adopts Final Rules for Shareholder Proxy Access

The SEC today adopted, by a 3-to-2 vote, final rules for the inclusion of shareholder nominees in company proxy statements. As expected, the final rules are structurally similar to last year's proposal, with no possibility for companies or their shareholders to opt-out or adopt more limited arrangements. The final rules do include some improvements over last year's proposal, including tighter standards for shareholder eligibility, rejection of "first to file" priority if there are too many nominees, provisions addressing the separation of voting rights from economic interests, and a three-year respite for small reporting companies. The rules will be effective 60 days from publication, in time for the 2011 proxy season, so now is the time for companies to review their governing documents to ensure compatibility with the proxy access framework. The key elements of the new regime are:

- New Rule 14a-11 gives shareholders and shareholder groups who have collectively held both investment and voting power of at least 3% of the voting power of a company's securities continuously for at least three years, the right to have nominees for director included on the company's ballot and described (in up to 500 words per nominee) in its proxy statement.
- Shareholders will be entitled to nominate up to a maximum of 25% of the entire board (with a minimum of one director), even if the company has a classified board with only one-third of the board up for election at that meeting (but shareholder nominees serving a three-year term will count against the 25% cap for the following two annual meetings).
- If shareholders propose more candidates than must be included in the proxy statement, priority is to be given to the candidates nominated by the largest shareholders or shareholder groups.
- In calculating the 3%, although the SEC did not adopt a broad "net long" definition, borrowed shares are excluded, short positions must be netted, and shares loaned out will count if they can be recalled and will in fact be recalled if the nominee is included.
- Shareholders intending to place nominees in a company's proxy statement must communicate their intent by filing a new Schedule 14N no earlier than 150 days, and no later than 120 days, prior to the anniversary of the mailing date for the prior year's proxy materials.
- Nominating shareholders must make specified disclosures, including as to their intent to hold the securities (which is required through the meeting for the minimum qualifying amount), and their not intending to change control of the company or nominate more than a quarter of the board. They must also disclose whether, to their knowledge, their nominees meet the company's director qualifications set forth in its governing documents (although failure to satisfy such qualification requirements would not preclude the nomination or election of a nominee even if he or she may not be eligible to serve as a director).
- Nominees would be required to satisfy any federal and state law eligibility requirements, as well as objective (but not subjective) independence standards of applicable exchange rules, in order to be considered.
- Companies seeking to exclude a shareholder nominee must, after giving the nominating shareholder an opportunity to cure perceived failures, provide notice to the SEC of their basis for the intended exclusion, and may seek "no-action" relief, no later than 80 days before the definitive proxy statement is filed.

The SEC also adopted amendments to narrow the "election exclusion" in Rule 14a-8(i)(8) which will allow shareholders to make proposals to broaden (but not narrow) proxy access, such as a lower ownership threshold, a shorter holding period or to allow for a greater number of nominees.

Although we have long argued that "one-size-fits-all" shareholder proxy access is a serious mistake, companies and investors must now learn to live with – and make the best of – this new reality. From the investor side, it will be up to shareholders that genuinely seek to enhance the long-term value of their investments to manage the proxy access regime responsibly, particularly when voting in a context of more frequent and sometimes frivolous election contests. For companies, this means finding ways to facilitate the new regime in a manner that advances corporate interests and avoids and minimizes the adverse consequences of which we have often warned. One thing that is clear is that the new regime will require a heightened emphasis on investor relations and more strategic and tactical thought being devoted to corporate governance issues.

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