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Legal Update
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U.S. SEC Adopts Proxy Access Rules

On August 25, 2010, the U.S. Securities and Exchange Commission ("SEC" or "Commission"), by a 3-2 vote, adopted final rules[1] (the "Adopting Release") on facilitating shareholder director nominations through issuer proxy statements, culminating years of consideration of this issue. The final proxy access rules provide that if certain conditions are met, a company will be required to include in its proxy statement shareholder nominations for director. The new rules will not be available if the shareholder is seeking to change control of the board of directors or to elect more members of the board than permitted by the rule. These rules will also require the inclusion in a company's proxy statement of shareholder proposals to amend a company's governing documents with respect to director nomination procedures. Once the proxy access rules become effective, they will be mandatory. No specified event will be needed to trigger the applicability of the rules. Companies will not need to "opt in" and companies may not "opt out."

The final proxy rules become effective 60 days after publication in the *Federal Register*, except that "smaller reporting companies," as defined in Rule 12b-2 pursuant to the Securities Exchange Act of 1934 (the "Exchange Act"), will not be subject to the new proxy access rules until three years after the effective date. Depending on when a public company mailed its proxy materials in 2010, the proxy access rules may be applicable for the 2011 proxy season. Notice of nominations for directors to be included in the issuer's proxy statement must be given at least 120 days before the anniversary date of the mailing of the proxy statement for the prior year's annual meeting. If this 120-day deadline falls after the effective date of the rules, the proxy access rules can be used to include shareholder nominees for directors in the proxy statement for the 2011 annual meeting. For example, as the SEC noted in the fact sheet[2] that accompanied its press release on the adoption of the proxy access rules, if the rules became effective on November 1, 2010, proxy access would be applicable for the 2011 proxy season for public companies that mailed their proxy statements for 2010 annual meetings no earlier than March 1, 2010.

Including Shareholder Director Nominations in a Company's Proxy Statement

Eligibility. The proxy access rules add new Rule 14a-11 to the proxy rules, governing the circumstances in which companies are required to include shareholder nominees for director in their proxy materials. Rule 14a-11 applies to all companies that are subject to the proxy rules, including investment companies, controlled companies and companies that have voluntarily registered a class of equity securities pursuant to Section 12(g) of the Exchange Act, unless they are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Exchange Act.

The new proxy access rules entitle qualified shareholders to have their director nominees included in the company's proxy statement. To be

qualified, a shareholder, either individually or as part of a group, must own at least 3 percent of the voting power of the securities of a class that is subject to the proxy solicitation rules and entitled to vote on the election of the company's directors and must have held this qualifying amount of securities continuously for at least three years. The nominating shareholders must agree to hold the qualifying amount of securities through the date of the meeting and disclose their intent with regard to continued ownership after the election of directors. The nominating shareholders must hold both investment and voting power of the qualifying securities, either directly or through any person acting on their behalf, in order for the securities to count in the calculation of total voting power of the company's securities held.

If a company has multiple classes of stock with unequal voting rights and the classes vote together on the election of directors, then voting power would be calculated based on the collective voting power. On the other hand, if classes of voting securities elect a subset of directors, then voting power would be determined only on the basis of the voting power of the class or classes of stock that would be voting together on the election of the person or persons sought to be nominated by the nominating shareholder or group, rather than the voting power of all classes of stock.

A nominating shareholder or group must demonstrate its requisite ownership with a statement from the registered holder, broker or bank dated within seven calendar days prior to the submission date of the notice of intent to require the company to include a nominee in its proxy materials on Schedule 14N. Alternatively, if the nominating shareholder or group has filed a Schedule 13D, Schedule 13G, Form 3, Form 4 or Form 5 reflecting such ownership as of or before the date the three-year eligibility period begins, such filing may be attached or incorporated by reference into the Schedule 14N.

For the purpose of calculating ownership percentages, the nominating shareholder or members of the nominating shareholder group will be able to include securities loaned to a third party so long as such shareholder or group members have a right to recall the securities that were loaned and agree to do so upon being notified that any of the nominees will be included in the company's proxy materials. However, securities sold short, and securities that are borrowed, must be deducted from the amount of securities that may be counted toward the required ownership threshold. Comparable calculation provisions apply to the determination of the three-year holding period. Nominating shareholders and members of a nominating shareholder group may rely on a company's most recent quarterly, annual or current report to determine total voting power unless the nominating shareholder or member of a nominating shareholder group knows or has reason to know that the information is inaccurate.

The nominating shareholder or member of a nominating group may not hold the company's securities with the purpose, or with the effect, of changing control of the company or gaining a number of seats on the board that exceeds the maximum number that the company could be required to include under Rule 14a-11. A nominating shareholder or a member of a nominating shareholder group under Rule 14a-11 may not:

- Be a member of any other group with persons engaged in solicitations or other nominating activities in connection with the election of directors
- Separately conduct a solicitation in connection with the election of directors (other than an exempt solicitation in relation to those nominees it has nominated pursuant to Rule 14a-11, or for or against the company's nominees)
- Act as a participant in another person's solicitation in connection with the election of directors.

Neither the nominating shareholder or group nor the nominee may have any agreements with the company or its management with respect to the nomination prior to the filing of the Schedule 14N. Failed negotiations between the nominating shareholder or group and the nominating committee to have the nominee included as a management nominee are not considered direct or indirect agreements with the company for the purposes of this rule.

Nominee Requirements. The new rules do not require a shareholder nominee to be included in a company's proxy materials if applicable state or foreign law, or the company's governing documents, prohibit shareholders from nominating candidates for election as directors. (In the Adopting Release, the SEC stated that it was unaware of any law in any state or in the District of Columbia that currently prohibits shareholders from nominating directors.) Similarly, a shareholder nominee is not required to be included in the company's proxy materials if the nominee's candidacy or board membership violates controlling federal law, state law, foreign law or stock exchange regulations (other than rules regarding director independence), and such violation cannot be cured in 14 calendar days after receipt of a timely notice of ineligibility from the company.

If the company is subject to stock exchange rules regarding independence, a shareholder nominee must be independent in accordance with the objective standards set forth by the applicable stock exchange, but the nominee need not be independent in accordance with any subjective or additional standards imposed by the company's board of directors. There is no limitation on relationships between the nominating shareholder or group and its nominee. However, once a nominee is elected to the board of directors, the Adopting Release notes that the director will be subject to state law fiduciary duties, and will owe the same duties to the company as any other director.

Maximum Number of Shareholder Nominees. Under Rule 14a-11, companies will only be required to include in their proxy statements the greater of one shareholder nominee or the number of shareholder nominees that represent 25 percent of the company's board of directors—if 25 percent does not equal a whole number, then this number is rounded down to the closest whole number *below* 25 percent. If there are directors serving on the board who were elected as shareholder nominees and who have terms continuing past the meeting, then the proxy materials would not have to contain more shareholder nominees than could result in the total number of shareholder-nominated directors exceeding the greater of one director or 25 percent of the company's board of directors.

If a company receives shareholder nominations pursuant to Rule 14a-11 from more than one shareholder or group, the number of available slots for shareholder nominees in the company's proxy statement would be filled based on which shareholder or group holds the highest percentage of the company's voting securities. (This is a change from the "first-come, first-served" basis initially proposed.) If the nominating shareholder or group withdraws or is disqualified after the company provides notice to the nominating shareholder or group of the company's intent to include the nominee or nominees in its proxy materials, the company will be required to include in its proxy statement and form of proxy the nominee or nominees of the nominating shareholder or group with the next highest voting power percentage that is otherwise eligible to use the rule and that filed a timely notice in accordance with the rule, if any.

Neither the composition of the nominating shareholder group nor the shareholder nominee may be changed to correct a deficiency identified in the company's notice to the nominating shareholder or nominating shareholder group.

If a company negotiates with the nominating shareholder or group that has filed a Schedule 14N and the company ultimately agrees to include such shareholder's or group's nominee in the company's proxy statement and proxy card as a company nominee, that nominee will count toward the 25 percent maximum set forth in the rule, assuming that such nomination would have otherwise been eligible under Rule 14a-11.

Concurrent Proxy Contests. Rule 14a-11 will apply regardless of whether the company is subject to a concurrent proxy contest, although the nominating shareholder or group may not participate in the proxy contest.

Schedule 14N. A nominating shareholder or group must file a Schedule 14N with the SEC and transmit it to the company on the same day in order to give notice of intent to require the company to include a shareholder nominee in the company's proxy materials. This must be so filed and transmitted no earlier than 150 calendar days, and no later than 120 calendar days, before the first anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting if the shareholder is proceeding under Rule 14a-11. If the shareholder is proceeding under applicable state or foreign law or under the company's governing documents, the Schedule 14N must be filed by the date specified in the company's advance-notice provision or, if none, no later than 120 calendar days prior to the first anniversary of the prior year's proxy mailing. (If the meeting date changes by more than 30 days from the prior year, the company must report that change on a Form 8-K, as discussed below.) The Schedule 14N is required regardless of whether a shareholder or group is relying on Rule 14a-11, applicable state or foreign law or the company's governing documents for proxy access.

The Schedule 14N will need to contain certifications with regard to control intent and nominating shareholder and nominee eligibility. In addition, the Schedule 14N must include:

- The name and address of the nominating shareholder or each member of the nominating group.
- The amount and percentage of company securities held by the nominating shareholder or group that are entitled to be voted at the meeting for the election of directors, and the voting power derived from securities that have been loaned or sold in short sales that remain open.
- A written statement from the registered holder, or the brokers or banks through which the shares are held, verifying, within seven calendar days prior to submitting the notice, that the nominating shareholder or group continuously held the qualifying amount of securities for at least three years.
- A statement of the nominating shareholder's or group's intent to hold the securities through the date of the meeting.
- A statement of the nominating shareholder's or group's intent with respect to continued ownership after the meeting.
- A statement that the nominee consents to be named in the proxy materials and to serve on the board of directors, if elected.
- Disclosure about whether the nominee meets the director qualifications set forth in the company's governing documents and a statement that the nominee meets the objective stock exchange independence criteria.
- Disclosures about the nominee and the nominating shareholder and relationships between the nominating shareholder, the nominee and/or the company.
- If desired, any statement in support of the shareholder nominee (which may not exceed 500 words) for inclusion in the proxy statement.
- Disclosure about voting power attributable to securities that have been loaned or sold in a short sale that has not been closed out.

Nominating shareholders or groups will need to obtain codes for the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system to file a Schedule 14N. The schedule would have to be amended promptly for any material changes in the facts disclosed or certifications made therein, including a withdrawal of the shareholder nomination. A final amendment would be required within 10 calendar days after the announcement of the final election results to update the nominating shareholders' intention with respect to continued ownership of shares.

The nominating shareholders will be subject to liability under Exchange Act Rule 14a-9 (the proxy rules' antifraud provision) for disclosures in their Schedule 14N and for all amendments thereto.

Requirements After a Notice is Received. Rule 14a-11 permits a company to exclude a shareholder nominee for director from its proxy statement in the following circumstances:

- Rule 14a-11 not being applicable to the company (for example, if the company only has registered debt securities)
- The nominating shareholder or group not complying with the applicable requirements of Rule 14a-11
- The nominee not meeting the requirements of Rule 14a-11
- The company receiving more nominees than it is required to include and the nominating shareholder or group not being entitled to have its nominee included under Rule 14a-11.

In addition, a company could exclude a supporting statement if it exceeds 500 words. A company may not exclude a nominee or a statement in support based on its view that Schedule 14N (which will include the statement in support) contains false or misleading statements.

If a company will include the shareholder nominee in its proxy statement, it must notify the nominating shareholder or group not later than 30 calendar days before filing its definitive proxy statement. If the nominating shareholder has submitted a statement of support for its nominee, that statement is required to be included in the company's proxy statement if the nominee is required to be included. The company and the nominating shareholder can each solicit in favor of their nominees outside of the proxy statement so long as the solicitations by the nominating shareholder comply with the SEC's new exemption, Rule 14a-2(b)(8), which is discussed below.

A company making the determination to exclude a shareholder nominee must notify the nominating shareholder or group and the SEC within the time frame indicated below. The company may also seek SEC staff concurrence on its determination that it is permissible to exclude a shareholder nominee from its proxy materials through a no-action letter process. Certain procedural deficiencies may be remedied by the nominating shareholder. This process is similar to the existing proxy rules for shareholder proposals pursuant to Rule 14a-8. The SEC Division of Corporation Finance has committed to devoting the resources necessary to respond to proxy access no-action requests in a timely fashion.

If a company includes a shareholder nominee for director in its proxy statement, the company will be required to include disclosure about the nominating shareholder or group and the nominee that is similar to the disclosure currently required in contested elections, as well as the nominating shareholder's or group's statement of support for its nominee, in its proxy statement. A company will not be required to file a preliminary proxy statement with the SEC solely because it includes a shareholder nominee and related supporting statement in its proxy statement.

Time Frame for Proxy Access Process. The Adopting Release includes the following chart showing how key timing of the proxy access process would work:

DUE DATE	ACTION REQUIRED
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	Nominating shareholder or group must provide notice on Schedule 14N to the company and file the Schedule 14N with the Commission
No later than 14 calendar days after the close of the window period for submission of nominations	Company must notify the nominating shareholder or group (or its authorized representative) of any determination not to include the nominee or nominees
No later than 14 calendar days after the nominating shareholder's or group's receipt of the company's deficiency notice	Nominating shareholder or group must respond to the company's deficiency notice and, where applicable, cure any defects in the nomination
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the Commission	Company must provide notice of its intent to exclude the nominating shareholder's or group's nominee or nominees and the basis for its determination to the Commission and, if desired, seek a no-action letter from the staff with regard to its determination
No later than 14 calendar days after the nominating shareholder's or group's receipt of the company's notice to the Commission	Nominating shareholder or group may submit a response to the company's notice to the Commission staff
As soon as practicable	If requested by the company, Commission staff would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group
Promptly following receipt of the staff's informal statement of its views	Company must provide notice to the nominating shareholder or group stating whether it will include or exclude the nominee

Proxy Card. If a shareholder nominee for director is included in a company's proxy statement pursuant to Rule 14a-11, applicable state or foreign law or the company's governing documents, the company's proxy card must provide for voting on each director separately. Slate voting for or against all of a company's nominees for director as a whole will not be permitted if a shareholder nominee is included on the proxy card.

Attendance at Meeting. The SEC's proxy access rules do not contain a requirement that the nominating shareholder or group be present at the shareholder meeting at which directors will be elected. The Adopting Release notes that state law will control what happens if a candidate is

not nominated at the meeting because the person supporting the meeting neither attends the meeting or makes other arrangements for the nomination to occur.

No Limits on Resubmission. The proxy access rules do not bar a person from submitting a nomination request, even if that shareholder or group presented a nominee who failed to receive a specified percentage of votes in previous elections. Similarly, there is no limit on the number of times that an individual could stand for election as a shareholder nominee.

Foreign Issuers. Foreign private issuers are not subject to the proxy rules pursuant to Exchange Act Rule 3a12-3 and therefore are not subject to the proxy access rules. Rule 14a-11 will apply to a foreign issuer that is otherwise subject to U.S. proxy rules if applicable foreign law does not prohibit shareholders from making nominations for directors.

Affiliate Status. The proxy access rules do not provide a safe harbor for affiliate status for a nominating shareholder or group. Therefore, those who use Rule 14a-11 to nominate a director will need to analyze their affiliate status on a case-by-case basis.

Exemptions From Other Proxy Rules. New Rule 14a-2(b)(7) contains an exemption from specified proxy rules for oral and limited written solicitations in connection with the formation of a nominating shareholder group, so long as the soliciting shareholder or group is not holding the company's shares with the purpose or effect of changing the control of the company or seeking more board seats than the company would be required to include under Rule 14a-11. Shareholders also could structure both written and oral solicitations to fall within existing exemptions from the proxy rules, such as the exemption for solicitations of not more than 10 shareholders or communications occurring in an electronic shareholder forum. Rule 14a-2(b)(8) contains a new exemption for solicitations by a nominating shareholder in support of a nominee that is or will be included in a company's proxy statement, provided that the nominating shareholder does not seek proxies. Both of these new exemptions only apply to solicitations with respect to nominations made pursuant to Rule 14a-11. They are not available with respect to nominations made pursuant to an applicable state or foreign law procedure or pursuant to the company's governing documents.

Shareholder Proposals Regarding Nomination Procedures

Rule 14a-8(i)(8). Under prior Rule 14a-8(i)(8), companies were permitted to exclude from their proxy statements shareholder proposals relating to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election. The SEC has amended Rule 14a-8(i)(8) to require companies to include in their proxy materials shareholder proposals to amend the companies' governing documents relating to nomination procedures or disclosures related to shareholder nominations. This rule change does not permit an amendment that conflicts with Rule 14a-11 or state law. That is, the shareholder proposal process under Rule 14a-8 cannot be used to eliminate or restrict the rights granted by Rule 14a-11 or state law. Subject to the foregoing, amended Rule 14a-8(i)(8) will permit proposals relating to nomination procedures that establish different ownership thresholds, holding periods or other qualifications or representations.

The amendments to Rule 14a-8(i)(8) also codify certain prior staff positions, permitting exclusion of a proposal to amend nomination procedures if it:

- Would disqualify a nominee who is standing for elections
- Would remove a director from office before his or her term expired
- Questions the competence, business judgment or character of any nominee

- Seeks to include a specific individual in the company's proxy materials for election to the board of directors
- Could otherwise affect the outcome of the upcoming election of directors.

New 8-K Item

If a company did not hold an annual meeting in the prior year, or if the date of the annual meeting has changed by more than 30 days from the prior year, the company will be required to file a Form 8-K within four business days of determining the anticipated meeting date. New Item 5.08 of Form 8-K requires such a company to disclose the date by which a nominating shareholder must submit a notice to include a nominee in the company's proxy statement. This deadline must be a "reasonable" time before the company mails its proxy materials. Failing to file such a Form 8-K on time will result in the company losing eligibility to use a Form S-3 registration statement.

Other Related Rules

Group Determinations. Forming a group solely for the purpose of nominating a director does not result in the nominating shareholder losing its eligibility to report beneficial ownership of 5 percent of a company's securities on the streamlined format of Schedule 13G, rather than on Schedule 13D. However, a group formed for this purpose would be analyzed in the same way as any other to determine whether its members constitute a group required to report beneficial ownership under Section 13(d) of the Exchange Act or are required to disgorge short swing profits and file reports pursuant to Section 16 of the Exchange Act.

Liability. The nominating shareholder or group will be liable under Rule 14a-9 for any false or misleading statement in the information contained in the Schedule 14N or it provides relating to including a shareholder nominee in a company's proxy statement, regardless of whether that information is ultimately included in the company's proxy statement. Rule 14a-11(f) specifically provides that the company is not responsible for information that is provided by the nominating shareholder and then repeated in the company's proxy statement. This is a change from the proposed rule, which would have made the company liable if it knew or had reason to know that the information is false or misleading. Rule 14a-18, which governs disclosures where the nominating shareholder is acting pursuant to a state or foreign law or company governing document requirement rather than pursuant to Rule 14a-11, contains a similar provision with respect to liability with regard to information that is provided by the nominating shareholder.

Interplay with State Law Proxy Access

Some state law provisions have been adopted that affect proxy access, with procedural frameworks different from the SEC's proxy access rules. For example, Section 112 of the Delaware General Corporation Law (the "DGCL") permits bylaws to provide that if a corporation solicits proxies with respect to an election of directors, it must include shareholder nominees for director in its proxy solicitation materials (including any form of proxy), in addition to individuals nominated by the board of directors, subject to procedures or conditions set forth in the bylaws. In addition, Section 113 of the DGCL permits bylaws to contain an expense reimbursement provision so that the corporation would reimburse the shareholder for expenses incurred in soliciting proxies in connection with the election of directors.

Rule 14a-11 does not permit companies to adopt bylaw provisions that will limit the proxy access granted by Rule 14a-11. According to the Adopting Release, if applicable state or foreign law has a proxy access framework that is different from the SEC's Rule 14a-11, a nominating shareholder or group may choose to proceed under Rule 14a-11 or the applicable state or foreign law provision. However, such a shareholder or group cannot pick and choose from among the differing aspects of the federal

and state or foreign law framework. Rather, the nominating shareholder or group must meet all requirements of the procedure that it selects.

Practical Considerations

With the exception of smaller companies that receive a three-year deferral under the proxy access rules, public companies will either first be subject to the proxy access rules for the 2011 proxy season or the 2012 proxy season, depending on the effective date of the new rules and when the company mailed its proxy materials for the 2010 proxy season. Therefore, there are many practical issues that companies subject to the SEC's proxy rules should begin to consider today in connection with the new proxy access framework:

- To the extent that a shareholder nominee is included in a company's proxy materials, it will be necessary to work through the mechanics of proxy tabulation with the company's transfer agent and proxy solicitor, if any. If a company has majority voting for directors, and the total number of company and shareholder nominees exceeds the number of positions on the board up for election (as it usually would), it will become necessary to determine whether a plurality voting standard will apply.
- While the proxy access rules specify that formation of a group solely for the purpose of causing a company to include a shareholder nominee in its proxy statement does not make group members ineligible to use Schedule 13G, the Adopting Release specifically states that "nominating shareholders will need to consider whether they have formed a group under Exchange Act Section 13(d)(3) and Rule 13d-5(b)(1)." Companies may have provisions in their governing documents or contracts (such as a "poison pill" shareholder rights plan), or be subject to state law provisions, that incorporate the Section 13(d) group concept. Therefore, it is advisable to review such provisions to determine the ramifications of shareholders forming a group to nominate a director under Rule 14a-11.
- Advance-notice bylaw provisions cannot limit the right granted to shareholders to include nominees for director in company proxy statements, although such provisions can provide an alternative procedural framework. Companies that have an advance-notice bylaw provision should consider whether they are seeking to provide an alternative framework for proxy access. If not, they should consider whether their provision is consistent with Rule 14a-11. Accordingly, existing advance-notice bylaw provisions should be reviewed and consideration should be given as to whether any amendments are warranted in light of SEC and other proxy access provisions. This review also provides an opportunity to consider whether an existing bylaw provision reflects the most current developments in advance-notice bylaw provisions.
- Public companies should review their corporate governance guidelines, nominating committee charters and bylaw provisions to determine if any amendments are advisable as a result of the SEC's proxy access rules. For example, some companies may wish to consider whether additional procedures are advisable to evaluate shareholder nominees. Some companies may adopt, or amend, director qualification standards applicable to all nominees. Because a footnote in the Adopting Release specifies that governing documents as used throughout the release and rule text generally refers to a company's charter, articles of incorporation, certificate of incorporation, declaration of trust and/or bylaws, companies should consider whether to move director qualifications to the bylaws (as opposed to corporate governance guidelines or the nominating committee charter) to assure that nominating shareholders will need to discuss any failure to meet such company standards.
- Some companies may want to consider revising, or proposing revisions to, their governing documents regarding director nomination procedures to make it less likely

that they will receive a shareholder proposal on such procedures. Although shareholders will now be able to use Rule 14a-8 for proposals addressing nomination procedures, they may have less incentive to propose more onerous provisions to the extent that the governing documents address nominations in a manner that the shareholders find reasonable.

- With shareholders being granted access to a company's proxy statement to propose nominees for directors, the role of the company's investor relations department will become increasingly important. Appropriate company employees should attempt to identify 3 percent shareholders, as well as any issues that are of particular concern to shareholders, such as executive compensation, financial performance or corporate governance. Awareness of the company's shareholder base and ongoing dialog to stay informed about shareholder concerns may forestall shareholder requests to include nominees in the company's proxy materials.
- Because failure to timely file a Form 8-K to report an annual meeting date that is more than 30 days from the anniversary of the prior year's meeting will result in loss of Form S-3 eligibility, companies should establish a control procedure so that when the annual meeting date is established a determination will be made as to whether a Form 8-K is due.
- A public company will need to include the deadline for submitting nominees for inclusion in its proxy statement in all proxy statements filed after the effective date of the proxy access rules.
- Given the greater prospect of board seats being held by directors as representatives for different shareholder constituencies, consider having directors sign confidentiality agreements or adopting corporate confidentiality, Regulation FD and conflict of interest policies that include directors, as an additional way to help protect the sanctity of board deliberations and the confidentiality of material board information. While these would apply to all directors, it is especially important to be sure that shareholder nominees understand their obligations to comply with such agreements and policies if elected.
- Small-cap and mid-cap companies, which historically have been less affected by the Rule 14a-8 shareholder proposals process, may be impacted by the proxy access rules to a greater degree than companies having large capitalizations since the 3 percent ownership hurdle is comparatively lower at smaller-cap companies from a dollars-invested standpoint. In addition, because hedge funds often constitute a greater percentage of the large investors in small- and mid-cap companies, it is possible that that there may be more shareholder activism by hedge funds through the proxy access rules with respect to these sized companies.
- Because shareholder access to company proxy statements for the purpose of nominating directors has the potential to affect governance by the board of directors, it is important to discuss the adoption of the proxy access rules with the board of directors and to promptly inform the board if the company receives indications, or a formal notice, that a shareholder or group will be using the process.
- The adoption of proxy access rules is not the only SEC development affecting the election of directors. Last year the SEC approved the amendment of NYSE Rule 452 to prevent brokers from voting in the election of directors if they do not receive voting direction from their clients, and the Dodd-Frank Wall Street Reform and Consumer Protection Act has made this a requirement of federal securities law. With large stockholders now being able to nominate directors in companies' proxy statements, and given the fact that smaller stockholders, especially retail investors, vote in fewer numbers, the implications on board elections could be significant. In addition, the SEC issued a concept release on "proxy

plumbing" issues which may result in future changes to the proxy system. For additional details, see our Legal Update dated August 18, 2010, "U. S. Securities and Exchange Commission's Proxy Plumbing Concept Release," available at http://www.mayerbrown.com/securities/article.asp?id=9496&nid=10707.

Endnotes

[1] See Release Nos. 33-9136; 34-62764; IC-29384, available at http://www.sec.gov/rules/final/2010/33-9136.pdf.

[2] See "Fact Sheet: Facilitating Rights of Shareholders to Nominate Directors," available at http://www.sec.gov/news/press/2010/2010-155.htm

If you have any questions regarding the SEC's proxy access rules, please contact the author of this Legal Update, Laura D. Richman, at +1 312 701 7304, or any of the lawyers listed below or any other member of our Corporate & Securities group.

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