

SEC Adopts Final Proxy Access Rules

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On August 25, 2010, the U.S. Securities and Exchange Commission (the “Commission”) adopted final “proxy access” rules and related amendments under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), to facilitate greater shareholder access to a company’s proxy materials for the nomination of director candidates. The final rules are based on rules proposed by the Commission on June 10, 2009, with several significant changes. A complete copy of the adopting release (SEC Release No. 33-9136) can be accessed at www.sec.gov/rules/final/2010/33-9136.pdf.

The final rules will become effective 60 days after publication in the Federal Register. Under new Rule 14a-11, shareholders seeking to nominate director candidates must do so no later than 120 calendar days before the one-year anniversary of the company’s mailing of its prior year’s proxy statement. Thus, if the final rules are effective by November 1, 2010, proxy access will be available to shareholders of companies which mailed their proxy materials for their last annual meeting on or after March 1, 2010. For smaller reporting companies, the effective date of Rule 14a-11 has been delayed for three years.

Rule 14a-11 will apply to all Exchange Act reporting companies (including certain registered investment

companies), except for companies that only have a class of debt registered under the Exchange Act. The final rules establish a mandatory method for proxy access, such that companies may not opt-out of the rules or adopt more restrictive procedures.¹

Rule 14a-11 – Director Nominations by Qualifying Shareholders

Rule 14a-11 permits 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. Under Rule 14a-11, a qualifying shareholder or group must give notice of its intended nominations by sending to the company, and filing with the Commission, a notice on new Schedule 14N.

Shareholder Eligibility Requirements

The final rules impose the following eligibility requirements on a shareholder or group seeking to propose a nominee under Rule 14a-11:

- **Ownership Threshold.** The shareholder or group must hold, as of the date of the Schedule 14N, at least 3% of the voting power of the company’s securities that are entitled to be voted on the election of directors. The shareholder or group must hold both investment and voting power, either directly or through any person acting on their behalf, of the securities.²

¹The only exemption from Rule 14a-11 is where applicable state or foreign law or a company’s governing documents prohibit shareholders from making director nominations.

²Shareholders are not permitted to borrow shares to satisfy the ownership threshold of Rule 14a-11. Shareholders may, however, count shares that have been loaned to others as long as they have the right to recall the shares and will do so if the company includes their nominee in its proxy materials.

- **Holding Period.** The shareholder or group must have held the qualifying amount of securities continuously for at least three years as of the date of the Schedule 14N and must continue to hold such securities through the date of the shareholder meeting.
- **No Change in Control Purpose or Effect.** The shareholder or group must not hold any of the company's securities with the purpose, or with the 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 that the company could be required to include under Rule 14a-11.
- **No Agreements With the Company.** The shareholder or group must not have any agreements with the company or its management with respect to the nomination.

Nominee Eligibility Requirements

A company will not be required to include a shareholder nominee in its proxy materials unless the following requirements are met:

- **Independence Qualification.** A nominee's candidacy or board membership must not violate federal or state law or applicable stock exchange requirements, other than subjective director independence requirements. The nominating shareholder or group is required to certify that each nominee meets the objective director independence requirements of the applicable stock exchange. A nominee is not, however, required to meet any heightened independence requirements applicable to members of certain board committees.

- **No Agreements With the Company.** The nominee must not have any agreements with the company or its management with respect to the nomination.

Maximum Number of Permitted Shareholder Nominees

Under Rule 14a-11, for each annual meeting of shareholders, a company will be required to include no more than one shareholder nominee or the number of nominees that represents 25% of the company's board of directors, whichever is greater.³ If a company agrees to include a shareholder nominee in its proxy materials as a company nominee, the nominee will count against the 25% maximum.

Where a company has a classified (staggered) board of directors, the final rules provide that the 25% limit will be calculated based on the total number of board seats, not the lesser number that are being voted on at the annual meeting. Where a company has a director (or directors) serving on its board of directors who was previously elected as a shareholder nominee pursuant to Rule 14a-11, and the term of that director extends past the date of the annual meeting, the company may reduce the number of permitted shareholder nominees by the number of such continuing directors.

If a company has more than one qualifying nominating shareholder or group, Rule 14a-11 gives priority to the nominating shareholder or group with the highest percentage of the company's voting power as of the date of filing the Schedule 14N. If a nominating shareholder or group withdraws or is disqualified, the company will generally be required to include the nominee of the shareholder or group with the next highest voting power percentage.

³In cases where 25% of the board of directors does not result in a whole number, the maximum number of nominees will be rounded down to the nearest whole number.

Schedule 14N – Notice and Disclosure Requirements

The nominating shareholder or group must provide the Schedule 14N to the company, and file it the Commission, no earlier than 150 calendar days, and no later than 120 calendar days, before the one-year anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting.⁴ Schedule 14N requires the following disclosures:

- the name and address of the nominating shareholder or each group member;
- the amount and percentage of securities held and entitled to vote on the election of directors at the meeting by the nominating shareholder or group;
- a statement verifying the satisfaction by the nominating shareholder or group of the three-year holding requirement;
- a statement confirming the nominating shareholder's or group's intent to hold the subject securities through the date of the shareholder meeting, and a statement regarding the 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 company's proxy statement and form of proxy and, if elected, to serve on the board of directors;
- information regarding the nominating shareholder or group and the nominee consistent with that currently required under the Commission's proxy rules for a contested election, including certain biographical information, disclosure of certain relationships and disclosure of certain legal proceedings;
- disclosure about 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;
- a statement that, to the best of the nominating shareholder's or group's knowledge, the nominee meets the objective criteria for independence of the applicable stock exchange;
- disclosure about the nature and extent of the relationships between the nominating shareholder and group, the nominee and/or the company or any affiliate of the company;
- disclosure of any website address on which the nominating shareholder or group may publish soliciting materials; and
- if desired to be included in the company's proxy statement, a statement in support of the shareholder nominees not exceeding 500 words per nominee.

Rule 14a-11 Eligibility Determinations

Upon receipt of the Schedule 14N, a company must determine whether the notice is proper under Rule 14a-11 and whether any provisions allow the company to exclude the shareholder nomination. If a company accepts the nomination, the company must notify the nominating shareholder or group of its acceptance, in writing, within 30 calendar days prior to the filing of the company's definitive proxy statement. The company will be required to include in its proxy materials the information about the nominating shareholder or group and the shareholder nominee, similar to what is currently required in a contested election.

⁴If the company did not hold an annual meeting during the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, the nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials. In that case, the company will be required to disclose the date by which shareholders must submit the required notice in a Form 8-K filed pursuant to new Item 5.08 within four business days after the company determines the anticipated meeting date.

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If a company determines that it is not required to include a nominee in its proxy materials under Rule 14a-11, the company must provide written notice to the nominating shareholder or group within 14 calendar days after the Schedule 14N filing deadline and give its basis for the exclusion. The nominating shareholder or group will then have 14 calendar days to respond to the company's deficiency notice and, where applicable, correct any eligibility or procedural deficiencies. If the company determines that it still may properly exclude the shareholder nominee, the company must provide notice of its determination to both the Commission and the nominating shareholder or group no later than 80 calendar days prior to filing its definitive proxy materials. If desired, the company also may seek a no-action letter from the Commission with regard to its determination.

Liability for Statements Made by a Nominating Shareholder or Group

A nominating shareholder or group will be liable under new Exchange Act Rule 14a-9(c) for any statement made in the Schedule 14N or related communications which, at the time and in light of the circumstances under which it is made,

is false or misleading with respect to any material fact or that omits to state any material fact necessary to make the statements therein not false or misleading, regardless of whether that information is ultimately included in the company's proxy statement. A company will not be liable for any information provided by a nominating shareholder or group under Rule 14a-11 that the company includes in its proxy statement, except to the extent that the company subsequently specifically incorporates the information by reference or "otherwise adopts the information as its own."

Amendments to Rule 14a-8(i)(8) – Shareholder Proposals

The final rules also amended Rule 14a-8(i)(8), which governs shareholder proposals relating to board elections. As amended, Rule 14a-8(i)(8) requires companies to include proposals to amend their governing documents and other proposals relating to director nominations in their proxy materials, subject to certain limited exceptions. The amendments will essentially permit shareholder proposals to broaden (but not limit) the Commission's proxy access rules.

This client alert is for general information purposes and should not be regarded as legal advice.