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## SEC Publishes Proposed Rule Facilitating Shareholder Director Nominations

On June 10, the Securities and Exchange Commission proposed changes to the federal proxy rules to permit certain shareholders broader access to company proxy materials for the purpose of nominating independent directors.

Shareholders do not currently have the right to include director nominees in a company's proxy statement. Rather, a shareholder seeking to nominate its own director nominee must mount its own proxy contest under the Commission's proxy rules. One of the primary stated reasons for the proposed rule changes is the expense and burden to shareholders participating in such proxy battles. In its release, the Commission states that including shareholder director nominees in company proxy materials would be "the most direct and effective method of facilitating shareholders' rights in connection with the nomination and election of directors."

### Proposed Rule 14a-11

Proposed Rule 14a-11 provides that a shareholder (or group of shareholders) holding a certain minimum percentage of a company's outstanding voting securities would be entitled to submit nominations for either one director or up to 25% of the company's directors (or rounded down to the nearest whole number of directors below the 25% threshold), whichever is greater, for inclusion in proxy materials. The proposed minimum stock ownership requirements for submission of nominees is 1% of outstanding shares for companies that are large accelerated filers, 3% of outstanding shares for companies that are accelerated filers, and 5% of outstanding shares of companies that are non-accelerated filers.

If a company receives more shareholder director nominees than it is required to include in its proxy materials, the company would include the first nominees submitted by a nominating shareholder or group within the applicable timeline. This could lead to a shareholder "race to file," which could be particularly odd if, after these rules are adopted, previous shareholder nominees already serve on a company's board. In calculating the number of shareholder nominees to include in its proxy materials, the company may include any incumbent directors who were elected as shareholder nominees under Rule 14a-11 whose terms extend past the date of the current annual shareholders' meeting. This appears to be applicable to companies with staggered boards.

For more information regarding the proposed rules, and to discuss what steps should be taken in the near term, please contact any of the following Katten Muchin Rosenman LLP attorneys:

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Katten's securities team includes 150 attorneys across our Securities, Securities Litigation and Financial Services practices, in the United States and London. Our attorneys provide sophisticated regulatory advice to public and private companies and other financial market participants. We have extensive experience with SEC disclosure and other public company requirements, regulation of broker-dealers, securities markets, investment funds and investment advisors, as well as the regulation of futures and derivatives.

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## Procedure for Shareholder Nominations

In order to submit a nominee for inclusion in the company's proxy statement, the nominating shareholder or group would be required to provide to the company a Schedule 14N and file it with the Commission. To be considered timely, Schedule 14N is required to be provided to the company and filed by the date specified in the company's advance notice provision, or if no such bylaw provision exists, no later than 120 calendar days before the one-year anniversary of the date the company mailed its proxy materials for the prior year's annual meeting.

Information provided on Schedule 14N includes:

- the name and address of the nominating shareholder (and each member of a nominating group);
- the amount and percentage of each shareholder's securities of the company beneficially owned and entitled to vote at the meeting;
- a certification that the shareholder continuously held the securities for at least one year prior to the date of the Schedule 14N;
- a statement of the shareholder's or group's intent to continue to own the requisite shares through the shareholder meeting at which directors are elected; and
- a certification that the securities are not held for the purpose of, or with the effect of, changing the control of the company or gaining more than a limited number of seats on the board of directors.

Schedule 14N also includes representations regarding the nominating shareholder's or group's eligibility to use Rule 14a-11 and disclosures about the nominating shareholder or group as well as the nominee for director. These disclosures would be similar to those required in a contested election, and would also be included in the company's proxy materials. In particular, the nominating shareholder or group must represent that the shareholder nominee is in compliance with generally applicable independence requirements of a national stock market.

A company may only exclude a shareholder nominee if (1) Rule 14a-11 is not applicable to the company (see below), (2) the nominating shareholder or group has not complied with the requirements of Rule 14a-11, (3) the nominee does not meet the independence requirements of Rule 14a-11, (4) any representation required to be included in Schedule 14N is false or misleading in any material respect or (5) the company has received more nominees than it is required to include in its proxy materials. If the company determines that the Schedule 14N meets the requirements of Rule 14a-11, it must notify in writing the nominating shareholder or group no later than 30 calendar days before the company files its definitive proxy statement and form of proxy with the Commission that it will include the nominee. The proposal also sets forth a detailed timetable for a company's notification to a nominating shareholder or group of its intention to exclude the nominee or nominees, the nominating shareholder response, notice to the Commission of the company's rejection of the response and the Commission's informal statement of its views on the matter.

Proposed Rule 14a-11 requires a company to include a nominating shareholder's or group's statement of support for the shareholder nominee or nominees which does not exceed 500 words. The statement must be provided to the company in the shareholder notice on Schedule 14N. Both the company and the nominating shareholder or group may solicit using additional soliciting materials which comply with the proxy rules.

Proposed Rule 14a-11 permits shareholders to aggregate their securities with other shareholders to achieve the applicable minimum ownership threshold to nominate a director. The Commission anticipates that shareholders would engage in communications with each other in an effort to form a nominating shareholder group under the proxy rules. As a result, the Commission is proposing an exemption from certain of the proxy rules to enable shareholders to form a shareholder nominating group for communications made in connection with proposed Rule 14a-11 that are limited in content and filed with the Commission.

Additionally, Rule 14a-11 includes an instruction stating that a nominating shareholder, or members of a nominating group, will not be deemed an "affiliate" of the company solely by reason of submitting a nomination.

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## Limitations on Applicability of Proposed Rule 14a-11

The proposed rules would apply to Exchange Act reporting companies with registered equity, including investment companies. However, Rule 14a-11 would not apply to companies which prohibit either under state law or the company's governing documents, shareholders from nominating candidates to the board of directors.

### Proposed Changes to Rule 14a-8(i)(8)

For companies which have governing documents prohibiting such shareholder nominations, shareholders desiring to amend such provisions may not, under the proposed amendments, be excluded from proposing such amendments in the company's proxy materials. Currently, Rule 14a-8(i)(8) provides a company with the right to exclude from its proxy statement a shareholder proposal that relates to a nomination or election to the board or a procedure for such nomination or election. The Commission proposes amending Rule 14a-8(i)(8) to remove a company's ability to exclude proposals regarding amendments to its governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided that the proposal does not conflict with proposed Rule 14a-11. Additionally, the proposal must satisfy the procedural requirements of Rule 14a-8 and not be subject to another substantive exclusion.

The Commission noted that while it is proposing an amendment to Rule 14a-8(i)(8), under certain circumstances, companies should continue to have the right to exclude proposals related to elections and nominations for directors. A proposal may be excluded under Rule 14a-8(i)(8) if it:

- would disqualify a nominee who is standing for election;
- would remove a director from office before his or her term expired;
- questions the competence, business judgment or character of one or more nominees or directors;
- nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision or a company's governing documents; or
- otherwise could affect the outcome of the upcoming election of directors.

### Other Proposed Rule Changes

Proposed Rules 14a-9(c), 14a-11(e) and 14a-19 provide that a nominating shareholder or shareholder group relying on proposed Rule 14a-11, applicable state law or a company's corporate governance documents will be held liable for any materially false or misleading information provided that is included in the company's proxy materials. In addition, as proposed, information provided to the company from a nominating shareholder or shareholder group in a notice on Schedule 14N that is included in the company's proxy materials will not be automatically incorporated by reference into any of the company's filings under the Securities Act, the Exchange Act or the Investment Company Act unless the company specifically determines to do so.

The Commission's release also proposes amending beneficial ownership reporting rules to ensure that shareholders eligible to file Schedule 13Gs maintain such eligibility when forming a group of shareholders solely for the purpose of nominating directors under proposed Rule 14a-11.

As to the determination of whether a group formed solely for the purpose of nominating a director pursuant to proposed Rule 14a-11, soliciting in connection with the election of such nominee or getting such nominee elected as a director, should be viewed as being aggregated together for purposes of the 10% ownership test of Exchange Act Section 16, the Commission does not propose any exclusion. Instead, the current analysis used for determining whether group members are owners of more than 10% of a class of equity security under Section 16 would continue to apply. This is in contrast to the Commission's 2003 proposal, in which the Commission proposed that members of a shareholder group formed for the sole purpose of nominating, soliciting for or electing a director under proposed Rule 14a-11 should not be viewed as owners of 10% of an equity security.

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## Prior Proposals Regarding Proxy Access

The current proposed rules are the Commission's third attempt at reforming shareholder proxy access over the past six years. In an effort to address concerns over this issue, the Commission proposed rules that would have allowed shareholder access to a company's proxy statement in both 2003 and 2007. In contrast to the current proposal, both earlier proposals contemplated a two-stage process with a triggering or enabling event in year one followed by shareholder access in year two. The Commission's 2003 proposal would have required the inclusion of a director nominee of a shareholder, or a group of shareholders, on a company's proxy if one or both of the following two triggering events occurred: (1) at least one of the company's nominees for the board for whom the company solicited proxies received withhold votes of more than 35% of the votes cast at an annual shareholders meeting, and (2) a shareholder proposal submitted to a vote of shareholders received more than 50% of the vote of shareholders holding more than 1% of the company's securities for more than one year. In 2007, the Commission's proposal would have required the inclusion of shareholder proposals for bylaw amendments concerning procedures for nominating directors in the company's proxy statement if the nominating shareholder owned more than 5% of the company's voting securities for more than a year and was eligible to file a Schedule 13G.

## Solicitation of Comments

The Commission's release sets out numerous questions with respect to each aspect of its proposals, in many cases highlighting interesting issues to be resolved. Below is a sampling of issues that the Commission is specifically seeking comments on through its release:

- Should proposed Rule 14a-11 be inapplicable to a company that has or adopts a provision in its governing documents that provides for or prohibits the inclusion of shareholder director nominees in the company proxy materials? Should the Commission's rules respond to variations in shareholder director nomination disclosures and procedures adopted under state corporate laws which specify that a company's governing documents may address the use of a company's proxy materials for shareholder nominees to the board of directors? Would it be more appropriate to only permit companies to comply with governing document provisions or state laws where those provisions or laws provide shareholders with greater nomination or proxy disclosure rights than those provided under proposed Rule 14a-11? Should Rule 14a-11 provide that a company's governing documents may render the rule inapplicable to a company only if the shareholders have approved, as contrasted to the board implementing without shareholder approval, a provision in the company's governing documents addressing the inclusion of shareholder nominees in company proxy materials? Should Rule 14a-11 be inapplicable if such shareholder-approved provisions are more restrictive than Rule 14a-11? Should Rule 14a-11 be inapplicable if such shareholder-approved provisions are less restrictive than Rule 14a-11? Or both? (B-7)
  - Should proposed Rule 14a-11 exempt companies where state law or the company's governing documents require that directors be elected by a majority of shares present in person or represented by proxy at the meeting and entitled to vote? What specific issues would arise in an election where state law or the company's governing documents provided for other than plurality voting? What specific issues would arise in an election that is conducted by cumulative voting? Would these issues need to be addressed in revisions to the proposed rule text? If so, how? (B-9)
  - Should Rule 14a-11 be widely available, as proposed, or should the rule be limited to companies where specific events have occurred to trigger operation of the rule? If so, what events should trigger operation of the rule? (B-13)
  - The proposed eligibility threshold is based on the percentage of securities owned and entitled to vote on the election of directors. This threshold is based on current Rule 14a-8 and reflects the Commission's intent to focus on shareholders eligible to vote for directors. Is the proposed threshold appropriate or could it be better focused to accomplish the Commission's objective? Should eligibility instead be based on record ownership? Should eligibility be based on the value of the shares owned? If so, on what date should the value be measured? What would be an appropriate value amount? Is there another standard or criteria? Is submission of the nomination the correct date on which to make these eligibility determinations? If not, what date should be used? (C-2)
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- Is it appropriate to use a tiered approach to the ownership threshold for reporting companies (other than registered investment companies)? If so, is it appropriate and workable to use large accelerated filer, accelerated filer and non-accelerated filer to define the three tiers? Are there aspects of the definitions of these groups that do not work with the proposed rule? Should the Commission instead define the tiers strictly by public float or market capitalization? If so, what should the public float or market capitalization thresholds be? (C-5)
- Is it appropriate to include a limitation on the number of shareholder director nominees? If not, how would the proposed rules be consistent with the Commission's intention not to allow Rule 14a-11 to become a vehicle for changes in control? If there should be a limitation, is the proposed appropriate? If not, should the maximum percentage be higher? Should the percentage vary depending on the size of the board? Should the limitation be the greater or lesser of a specified number of nominees or percentage of the total number of directors on the board? Is it appropriate to permit more than one shareholder nominee regardless of the size of the company's board of directors? (E-1 and E-2)

## Text of Commission's Release

The text of the release is available [here](#).

## What Companies Should Do Now

Because the Commission is soliciting comments on the proposed rules through August 17, and because the proposed rules, if finally promulgated, will bring fundamental change to the manner in which companies are governed, companies and their advisers may wish to submit comments on these proposals. Comments need not be confined to those specifically solicited by the Commission. We expect that the SEC will be particularly sensitive to comments and suggestions from all interested parties that are focused on making these new rules as practical as possible.

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