

## SEC PROPOSES TO MODIFY PROXY RULES TO FACILITATE RIGHTS OF SHAREHOLDERS TO NOMINATE DIRECTORS

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On May 20, 2009, the Securities and Exchange Commission (“SEC” or “Commission”) voted to propose rule amendments to facilitate the rights of shareholders to nominate directors on corporate boards. These rules, if adopted, would apply to both operating companies and registered investment companies.

### **Overview:**

Congress and the SEC have recently expressed concerns regarding whether public company boards are exercising appropriate oversight over management, whether boards are appropriately focused on shareholder interests, and whether boards need to be held more responsible for their decisions regarding such issues as compensation structures and risk management. Because of these concerns, the Commission has decided to reconsider whether and how the federal proxy rules may be impeding the ability of shareholders to exercise their fundamental right under state law to nominate and elect members to company boards of directors.

### **Background:**

Under the currently prevailing electoral regime, when public companies hold elections to select members of their boards of directors, the existing directors nominate the slate of candidates and the company sends information to the shareholders, through so-called proxy materials, so those shareholders have information to vote their shares. Because the shareholders rarely have any input into the slate of candidates, however, they are not always able to vote for the person they believe may be best suited to fill the post. While many companies permit shareholders to show up to the annual shareholder meeting where the election occurs and nominate different candidates than the ones on the ballot, by then it is too late to be meaningful because the proxy votes will have already been cast. As a result, shareholders who wish to nominate their own candidates today must launch a proxy fight in which they mail out their own ballots – an extremely costly process.

To address this situation, the Commission is proposing rule amendments that would provide shareholders with a meaningful ability to exercise their state law rights to nominate the directors of the companies that they own. Under the proposal, shareholders who otherwise are provided the opportunity to nominate directors at a shareholder meeting would be able to have their nominees included in the company proxy ballot that is sent to all voters. Shareholders would also have the ability to use shareholder proposals to modify the company’s nomination procedures or disclosure about elections, so long as those proposals do not conflict with state law or Commission rules.

### **Getting Nominees Included in the Company’s Proxy Materials:**

*New Exchange Act Rule 14a-11 – shareholders could, under certain circumstances, include a nominee or nominees for director in company proxy materials*

Under the proposed rule, certain shareholders would be able to include their nominees for director in the company's proxy materials unless the shareholders are otherwise prohibited – either by applicable state law or a company's charter/bylaws – from nominating a candidate for election as a director. The proposed rule would apply to all Exchange Act reporting companies, including investment companies, other than debt-only companies.

***Which shareholders would be able to have their nominees included in the proxy materials?***

- 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.
  - 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.
- Shareholders would be able to aggregate holdings to meet applicable thresholds.
- Shareholders would be required to have held their shares for at least one year.
- Shareholders would be required to sign a statement declaring their intent to continue to own their shares through the annual meeting at which directors are elected.
- Shareholders would be required to 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.

***What requirements would a shareholder's nominee be required to meet to be nominated?***

- 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.

***How many board nominees for director would a shareholder be able to include in company proxy materials?***

- No more than one shareholder nominee or a number of nominees that represents up to 25 percent of the company's board of directors, whichever is greater. (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.)

***What would have to be disclosed about nominating shareholders and their nominees?***

- The nominating shareholder would be required to file with the Commission and submit to the company a new Schedule 14N. The 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. The Schedule 14N would 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.

***Would the nominating shareholder be liable for information provided to the company?***

- As is the case when directors nominate candidates, the 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 proposed rule would provide that the company will not be responsible for information provided by the shareholder, unless the company knows or has reason to know the information is false.

**Allowing Shareholders Proposals:**

***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 the Commission's rules.***

Currently, Exchange Act Rule 14a-8(i)(8) permits companies to exclude shareholder proposals that "relate to an election." Under the proposal, this so-called "election exclusion" would be narrowed, thereby allowing in the proxy materials more shareholder proposals regarding elections. Specifically, shareholder proposals by qualifying shareholders 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 don't conflict with proposed Rule 14a-11 above) would not be excludable.

***Which shareholders would be able to submit a shareholder proposal?***

- The current eligibility provisions of Rule 14a-8 would continue to apply. Those provisions require that a shareholder proponent have 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.

The SEC is accepting public comments on these proposed rule amendments during the 60 days after their publication in the Federal Register.

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