

July 6, 2009

SEC Proposes Rule Amendments Facilitating Shareholder Proxy Access to Nominate Directors

On June 10, 2009, the Securities and Exchange Commission released proposed proxy rule amendments that would facilitate the rights of shareholders to nominate directors to a company's board of directors. The rules would require a company, under certain circumstances, to include a shareholder's (or group of shareholders') director nominees in the company's proxy materials sent to all shareholders. The proposed rules would also require a company, under certain circumstances, to include in the company's proxy materials shareholder proposals that would amend, or request an amendment to, the company's director nomination procedures or disclosure provisions related to shareholder nominations. The proposed rules would apply to all Exchange Act reporting companies (including certain registered investment companies) except for companies that have only a class of debt registered.

Proposed Exchange Act Rule 14a-11

Proposed Rule 14a-11 would permit a shareholder or multiple shareholders acting together to include their nominees in the company's proxy materials unless otherwise prohibited by state law or a company's charter/by-laws from nominating a director. Note that if a company's governing documents prohibit nomination rights, shareholders who want to amend the provision may seek to do so by submitting a shareholder proposal.

Currently, shareholders may nominate their own director candidates in only limited ways. Shareholders may attend the annual shareholder meeting and nominate candidates at the meeting,

assuming the shareholders have complied with any advance notice requirements in the company's by-laws prior to the meeting. However, as a practical matter, such nominations are rarely effective. Normally, management will have obtained sufficient proxy votes by the time of the meeting to elect its candidates. A shareholder may also propose to management a candidate to be nominated as a management nominee, but management has no obligation to nominate the shareholder's candidate. In most situations, the only other alternative for shareholders is to launch a costly proxy contest in which they mail out their own proxy materials relating to their director nominees.

Shareholder Eligibility Requirements

To use proposed Rule 14a-11, a nominating shareholder or shareholder group must:

- Meet certain ownership threshold requirements depending on the company's size as of the date of the shareholder notice on Schedule 14N (discussed below):
 - 1% of the voting securities for large accelerated filers (companies with a market capitalization of \$700 million or more);
 - 3% of the voting securities for accelerated filers (companies with a market capitalization of \$75 million or more but less than \$700 million); and
 - 5% of the voting securities for non-accelerated filers (companies with a market capitalization of less than \$75 million).

- Have beneficially owned the requisite percentage of shares continuously for at least one year as of the date of the shareholder notice on Schedule 14N.
- Represent their intent to continue to own the securities through the date of the annual meeting.
- Not acquire or hold the securities for the purpose or with the effect of changing control of the company or to gain more than a limited number of board representatives.
- Provide to the company and the SEC a notice on proposed new Schedule 14N containing certain required disclosure.

Shareholder Nominee Requirements

- A company may exclude a shareholder nominee from its proxy materials if the nominee’s candidacy or subsequent election would violate controlling state law, federal law, or rules of the applicable national securities exchange or national securities association, and such violation could not be cured.
- The nominating shareholder or group must represent that the shareholder nominee is in compliance with the independence requirements of the applicable national securities exchange or national securities association.
 - The nominee would be required to meet the definition of “independent” that is applicable to directors of the company generally and not any heightened definition of independence applicable to members of the audit committee.
 - An independence standard that requires a subjective determination by the board would not have to be satisfied.
- The nominating shareholder or group must represent that neither the nominee nor the nominating shareholder (or any member of the nominating shareholder group, if applicable) has

an agreement with the company regarding the nomination of the nominee.

- This is intended to prevent the use of Rule 14a-11 by the company or its management through a “surrogate” shareholder (e.g., to block usage of the rule by another nominating shareholder).
- Unsuccessful negotiations with the company to have the nominee included on the company’s proxy card as a management nominee, or negotiations that are limited to whether the company is required to include the shareholder nominee for director on the company’s proxy card in accordance with Rule 14a-11, would not be considered an agreement with the company for purposes of the rule.
- Shareholders would be permitted to nominate one nominee or a number of nominees that represents up to 25% of the board, whichever is greater.
 - Where a company has a staggered board and a current director (or directors) previously elected as a shareholder nominee pursuant to Rule 14a-11 who will continue to serve as a director beyond the upcoming director elections, that director(s) would count towards the 25% cap and the company would not be required to include in its proxy materials shareholder nominees that would exceed the cap.
 - Where more than one shareholder or group would be eligible to have its nominees included in the company’s proxy materials, the company would be required to include the nominee or nominees of the first nominating shareholder or group from which it receives timely notice, up to and including the total number of shareholder nominees required to be included by the company.

Notice and Disclosure Requirements

- Proposed Rule 14a-11 would require that the nominating shareholder or group provide a notice on Schedule 14N to the company of its intent to have the company include that shareholder's or group's nominee or nominees in the company's proxy materials.
- The Schedule 14N must also be filed concurrently with the SEC.
- The Schedule 14N must be provided to the company and filed by the date specified by any applicable advance notice provision of the company or, where no such provision is in place, no later than 120 days before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting.
 - If the company did not hold an annual meeting in the prior year, or if the date of the meeting has changed by more than 30 days, the nominating shareholder will only be required to provide "reasonable" notice to the company, and the company must disclose the date by which the shareholder must submit the Schedule 14N in a Form 8-K filed pursuant to proposed Item 5.07 within four business days after the company determines the anticipated meeting date.
- The Schedule 14N must include:
 - Name and address of nominating shareholder or each member of the nominating shareholder group;
 - Amount and percentage of securities beneficially owned and entitled to vote;
 - Written statement from the "record" holder of the shares verifying that the shareholder continuously held the securities for at least one year;
 - The nominating shareholder's or group's intent to continue to own the requisite shares through the shareholder meeting as well as intent with respect to continued ownership after the election;
 - Certification that the nominating shareholder or group is not seeking to change the control of the company or to gain more than a limited number of seats on the board of directors;
 - Representations concerning the nominating shareholder's or group's eligibility to use Rule 14a-11;
 - Disclosure meeting the requirements of proposed Rule 14a-18 (including representations that the shareholder nominee's candidacy or board membership would not violate any applicable law, that the shareholder nominee is in compliance with the independence requirements described above, and that no relationships or agreements exist between the shareholder nominee and the company, or between the nominating shareholder or group and the company);
 - The shareholder nominee's consent to be named in the company's proxy statement and to serve on the board if elected;
 - Disclosure about the shareholder nominee and the nominating shareholder complying with the requirements of Schedule 14A;
 - Disclosure regarding the nature and extent of the relationships between the nominating shareholder or group and nominee and 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, any statement not in excess of 500 words in support of any shareholder nominee.

The Schedule 14N must be amended promptly for any material changes from a previously filed Schedule 14N.

Procedure upon Receipt of Notice

Upon receipt of a shareholder’s or group’s Schedule 14N, the company must make a determination whether it may exclude the shareholder nominee or nominees. A company may exclude a shareholder nominee from its proxy materials if it determines any of the following:

- Rule 14a-11 is not applicable to the company;
- The nominating shareholder or group has not complied with the requirements of Rule 14a-11;
- The shareholder nominee does not meet the requirements of Rule 14a-11;
- Any representation required to be included in the Schedule 14N is false or misleading in any material respect; or
- The company has received more nominees than it is required to include by Rule 14a-11.

If the company determines to exclude a shareholder nominee from its proxy materials, the following procedure then applies:

- The company must notify the nominating shareholder or group in writing within 14 days after receipt of the Schedule 14N of the company’s determination, including an explanation of the company’s basis for the determination.
- The nominating shareholder or group would then have 14 days to respond to the company notice and correct any eligibility or procedural deficiencies identified.
 - Neither the composition of the nominating group nor a shareholder nominee may be changed as a means to correct a deficiency, except to reduce the number of nominees if it exceeds the 25% cap.

- If, upon review of the nominating shareholder’s response, the company determines that it may still exclude a shareholder nominee, the company must provide notice to the SEC and the nominating shareholder or group of the basis for exclusion no later than 80 days before the company files its definitive proxy statement.
- The nominating shareholder or group may submit a response to the company and the SEC no later than 14 days after the nominating shareholder’s or group’s receipt of the company’s notice.
- The SEC staff may, at its discretion, provide a no-action letter to the company and the nominating shareholder or group.
- The company must provide the nominating shareholder or group with notice, no later than 30 days before it files its definitive proxy statement, of whether it will include or exclude the shareholder nominee(s).

When a shareholder nominee is included in a company’s proxy materials, the company may not provide shareholders the ability to vote for management nominees as a group, but instead must require that each director nominee be voted on individually.

Proposed Amendments to Exchange Act Rule 14a-8(i)(8)

The SEC also proposed amendments to existing Rule 14a-8(i)(8), which currently permits a company to exclude shareholder proposals that relate to a nomination or an election. These proposed amendments would narrow the exclusion right and would permit shareholders, under certain circumstances, to submit proposals to amend a company’s governing documents concerning nomination procedures or disclosure provisions related to shareholder nominations. The proposals must not be otherwise excludable under Rule 14a-8 and must not conflict with applicable state law or SEC rules, including

proposed new Rule 14a-11. For example, revised Rule 14a-8(i)(8) would allow a shareholder to propose amendments that establish procedures for nominating directors and disclosures related to such nominations that require a less restrictive ownership threshold, holding period, or other qualifications or representations than those proposed in Rule 14a-11 (so long as they do not conflict with Rule 14a-11).

Revised Rule 14a-8 (i)(8) would only permit a company to exclude a shareholder proposal 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.

Comments on the proposed rule changes may be submitted to the SEC until August 17, 2009. A complete copy of SEC Release No.33-9046 can be found at

<http://www.sec.gov/rules/proposed/2009/33-9046.pdf>.

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