

THOUGHT LEADERSHIP

LEGAL UPDATES

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Securities &
Corporate
Governance

Professionals

JAMES M. ASH
KANSAS CITY:
816.983.8000
JAMES.ASH@
HUSCHBLACKWELL.COM

STEVEN R. BARRETT
CHATTANOOGA:
423.757.5905
STEVE.BARRETT@
HUSCHBLACKWELL.COM

STEVEN F. CARMAN
KANSAS CITY:
816.983.8153
STEVE.CARMAN@
HUSCHBLACKWELL.COM

DAVID E. GARDELS
OMAHA:
402.964.5027
DAVID.GARDELS@
HUSCHBLACKWELL.COM

KIRSTIN P. SALZMAN
KANSAS CITY:

SEC Adopts Final Rules on Shareholder Proxy Access

On September 16, 2010, the Securities and Exchange Commission's new proxy access rules were published in the Federal Register. These rules, which will go into effect on November 15, 2010, will require public companies to allow certain shareholders to include director nominees in the companies' proxy materials. Additionally, the SEC established new ground rules for shareholder proposals that seek to change the director nomination process.

The new and amended proxy access rules apply to all public companies and registered investment companies other than public companies whose only public securities are debt securities. Companies that mailed their proxy materials on or after March 15, 2010 must be prepared to comply with the new requirements for the 2011 proxy season. Smaller reporting companies (those with a public float of less than \$75 million) have a three-year grace period to comply with the shareholder nomination rules, but in the meantime must give their shareholders access to the proxy to include proposals to amend the bylaws or charter concerning proxy access.

OVERVIEW OF PROXY ACCESS RULES

Shareholder Eligibility

To be eligible for enhanced proxy access under Rule 14a-11, shareholders must meet the following requirements:

Own at least 3% (the "Minimum Threshold") of the total voting power of the company's securities (which may be aggregated among a group of shareholders) that are entitled to be voted on at the election of directors at the annual meeting

Maintain the Minimum Threshold continuously for a three-year period prior to the date that the shareholder (or group) notifies the company of its proposed nominees and continues to own such shares through the date of the annual or special meeting

Additional requirements and limitations concerning these qualifications, including their application to shareholder groups formed to satisfy the Minimum Threshold are included in our comprehensive analysis.

Number and Qualifications of Nominees

Shareholders may nominate the greater of either one nominee or the number of nominees that represents 25% of the company's board of directors. If there is a staggered board, then the 25% calculation is based on the total number of board seats. If multiple shareholders submit more nominees than allowed under the rule, the company must give priority to the nominating shareholder with the highest qualifying voting percentage. However, if management engages in discussions or negotiations with the nominating shareholder about a nominee after the shareholder files a new Schedule 14N and then subsequently agrees to include the candidate on the proxy card as a company nominee, the nominee will count toward the 25% maximum.

All nominees must satisfy the applicable objective director independence standards of the company's listing exchange or, in the case of an investment company, must not be an "interested person" as defined by statute. Additionally, the nominee's candidacy or inclusion on the company's board of directors must not violate state, federal or foreign law. Neither the nominating shareholder nor the nominee may have a direct or indirect agreement with the company regarding the nomination; however, there are no restrictions on the relationship between the nominating shareholder and the nominee.

Notice and Disclosure Requirements

Shareholders must file a "Notice of Intent on Schedule 14N" with the SEC and provide a copy to the company at least 150 days, but not less than 120 days, before the anniversary of the prior year's proxy statement's mailing date. The Schedule must include:

Disclosures concerning the nominating shareholder or group, including information required to satisfy the eligibility criteria

Disclosures concerning the nominee(s), including biographical information and a description of the nature and extent of the relationships between the nominating shareholder and nominees and the company

Certifications relating to the shareholder's eligibility and the accuracy of the information provided. The Schedule may also include a short statement (500 words or less) of support for the nominee. None of the information provided by the shareholders will be treated as having been incorporated into any of the company's other SEC filings unless the company specifically indicates otherwise. The company is not liable for any misstatements contained in the information provided by the shareholder.

Review and Approval Process

After receiving the Schedule 14N, the company must notify the shareholder of its intention to include the nominee(s) in the company's proxy materials or exclude the nominee(s). If the company refuses to include the nominee, the company must include an explanation of the basis for the exclusion and allow the shareholder to remedy the deficiencies. If, following the shareholder's response, the company still objects to the nominee(s), the company must notify the SEC and if desired, submit a no-action request. The notice must be given to the SEC no later than 80 days before the company files its definitive proxy statement.

Revised Rule Related to Changes to Director Nomination Process

Amendments to Rule 14a-8 require companies to include proposals from qualifying shareholders that seek to establish director nomination procedures in the company's governing documents, as long as these proposals do not conflict with or limit the procedures adopted under Rule 14a-11, or applicable provisions of state, federal or foreign law. For example, if a company's charter or bylaws prohibit shareholder nomination rights, shareholders who wish to amend the provision may submit a shareholder proposal and the company cannot exclude the proposal under Rule 14a-8. The amendments do not alter the existing eligibility requirements for shareholder proposals under Rule 14a-8, namely stock ownership of the shareholder proponent of \$2,000 in market value (or 1%, if less) for at least one year prior to submitting the proposal. The amendments also codify certain SEC staff interpretations that permit companies to exclude any shareholder proposal that:

Seeks to disqualify any director nominee standing for election

Seeks to remove any director from office before his or her term expires

Questions the competence, business judgment or character of any nominee or director

Nominates an individual for election to the board other than through the Rule 14a-11 process, applicable state law provisions, or applicable provisions of the company's governing documents; or

Otherwise affects the outcome of the upcoming election of directors

What This Means To You

Practical steps to prepare for the impact of these proxy access rules in the 2011 proxy season include:

Identify existing 3% shareholders, or known activist shareholders who might attempt to form a 3% nominating group, and prepare to proactively engage with them on “hot button” issues that could motivate a Rule 14a-11 nomination, such as concerns over matters involving corporate governance, executive compensation or the company’s financial performance

Review the company’s advance notice bylaw provisions to determine whether changes are needed in light of the SEC’s new rules

Update the company’s disclosure controls and procedures to assure compliance with new disclosure requirements related to shareholder nomination deadlines, including any required filings under new item 5.08 of Form 8-K, which is not subject to the “safe harbor” for preserving Form S-3 eligibility

Consider amending the company’s corporate governance guidelines, nominating committee charter and/or bylaws to address responsibilities associated with these new proxy access requirements

Consider whether any existing qualifications for directors should be revised and/or moved into one of the company’s “governing documents” as defined in the SEC’s adopting release (e.g., the charter or bylaws as opposed to corporate governance guidelines), to ensure that nominating shareholders will be required to address their nominees’ compliance with such qualifications

Engage in early, proactive discussions with company’s transfer agent and any proxy solicitor to address any necessary modifications to the proxy solicitation and vote tabulation process when a shareholder submits a new Schedule 14N

If one or more shareholder-nominated directors are elected to the company’s board, the company should consider whether any changes are needed to its internal policies regarding conflicts of interest, Regulation FD compliance and similar matters that may be impacted by the addition of such directors.

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