# Proxy Access Rule:
# A Major Change in Governance is in Limbo

After years of discussion, the Securities and Exchange Commission recently adopted controversial new rules that require public companies to include the director nominees proposed by their large shareholders or shareholder groups in their proxy materials. The SEC believes that the new rules will improve corporate suffrage, the disclosure provided in connection with corporate proxy solicitations and communications between shareholders in the proxy process. Critics of the new rules argue that they empower special interests to pursue narrow, short-term agendas at the expense of the majority of retail shareholders.

Although the new rules will by their terms be effective as of November 15, 2010, the SEC has agreed to stay their effectiveness pending a judicial review of certain claims by the U.S. Chamber of Commerce and Business Roundtable that the rules are arbitrary and capricious in violation of the Administrative Procedure Act and that the SEC failed to assess the rules' effects on "efficiency, competition and capital formation," as required. It is likely that the judicial review will take months, casting doubt on whether the new rules will be effective in the 2011 proxy season.

**Shareholder Criteria**

To ensure that shareholders making nominations under new Exchange Act Rule 14a-11 have a long-term commitment and interest in the company they must meet the following ownership criteria:

1. The individual shareholder or shareholder group must own at least three percent (3%) of the voting power of the company’s stock. Under new Exchange Act Rule 14a-2(b), shareholders may engage in communications with other shareholders in an effort to aggregate their percentage ownership interests to meet the three percent threshold. Shareholders may file with the SEC and provide to the company a Schedule 14N, providing their name(s) and percentage ownership interests, name(s) and brief description(s) of their nominees, and the means by which they can be contacted by other shareholders interested in forming a group;

2. The shareholder or shareholder group must have continuously owned the shares for at least three years prior to filing the Schedule 14N providing their director nomination(s); and

3. The shareholder or shareholder group must own the shares through the date of the annual or special meeting.

**Nominations**

The shareholder or shareholder group may nominate either one director or 25 percent of the board, whichever is greater. If the company has a staggered board (i.e., a board whose members are elected for terms which commence in different years), the percent should be calculated based on the total number of directors on the board rather than the number of directors being elected at any one time. The SEC has stated that the new rules were not adopted to encourage shareholders to change control of a company, and the nominating shareholders must certify that they are not using new Exchange Act Rule 14a-11 to that effect.

Should the largest shareholder or shareholder group not make all the permitted nominations, then the next largest requesting shareholder or shareholder group's proposed nominees must be included in the proxy materials until all permitted director nominations have been provided. The director(s) listed on the proxy statement may change annually based on the largest shareholder or shareholder group at such time and its nomination(s). Prior years' nominees are not required to be included in the proxy statement, unless they continue to qualify as the nominees of the largest group.

To make the nominations, the shareholder or shareholder group must file with the SEC and provide to the company a Schedule 14N providing the nominee(s) name and not more than a 500 word statement per nominee.

The company is then required to include the shareholder nominee(s) on its proxy card, but may identify the shareholder or shareholder group that made such nomination(s), determine the order of the nominees and recommend whether shareholders should vote for, against, or withhold votes for such nominee(s).

**Amendment of Governing Documents**

In addition to providing shareholders with the opportunity to include specific director nominations under new Exchange Act Rule 14a-11, new Exchange Act Rule 14a-8 allows shareholders to make proposals, to be included in the company's proxy statement, to amend the company's governing documents with respect to procedures to nominate directors. New Exchange Act Rule 14a-8 limits the instances when a company can exclude a shareholder proposal in this context to when it would:

- Disqualify a nominee who is standing for election;
- Remove a director from office before his or her term expired;
- Question the competence, business judgment or character of one or more nominees or directors;
- Seek to include a specific individual in the company proxy materials for election of the board of directors (other than under the new Exchange Act Rule 14a-11); or
- Otherwise could affect the outcome of the upcoming election of directors.

**Timing**

A Schedule 14N providing the nominee(s) name and statement(s) must be provided to the company and the SEC between 150 and 120 days prior to the anniversary date that the company mailed its proxy materials for the prior year's annual meeting. This means that for most companies, but for the stay, the new rules would have taken effect in the 2011 proxy season.

The new rules do not apply to foreign private issuers. For smaller reporting companies, defined as companies that have a public float of less than $75 million, the application of the new rules will be delayed for three years. The SEC believes that the delayed effective date should allow the smaller reporting companies to observe how the new rules operate for the larger companies and allow them to better prepare for their own implementation.

However, as previously noted, within a few days of the new rules' adoption, the SEC agreed to stay its effectiveness pending judicial review of a challenge to its validity. Although expedited review has been sought, it is difficult to predict how long the review may take and its outcome. Therefore, the new rules may not be effective in the 2011 proxy season.

If you have any questions about this Client Alert, please contact:

**Allan Grauberd**
212.554.7883
agrauberd@mosessinger.com

**Arnold N. Bressler**
212.554.7636
abressler@mosessinger.com

**Wai Y. Chan**
212.554.7602
wchan@mosessinger.com

**Shari A. Ness**
212.554.7894
sness@mosessinger.com

**Carlos F. Ramirez**
212.554.7826
cramirez@mosessinger.com

**Mary Kostopoulos**
212.554.7802
mkostopoulos@mosessinger.com

## MOSES & SINGER LLP

Moses & Singer's Corporate, Securities and M&A practice represents clients concerning ongoing securities and regulatory matters, including periodic reporting under the Securities Exchange Act of 1934. We advise clients regarding corporate governance, stockholders meetings, listing requirements of securities exchanges, development and implementation of equity incentive plans, investor relations and analyst issues, PCAOB concerns, securities litigation and the broad spectrum of regulatory matters applicable to public issuers. Our representation extends to matters arising under the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisors Act of 1940.

Since 1919, Moses & Singer has provided legal services to diverse businesses and to prominent individuals and their families. Among the firm's broad array of U.S. and international clients are leaders in banking and finance, entertainment, media, real estate, healthcare, advertising, and the hotel and hospitality industries. We provide cost-effective and result-focused legal services in the following primary areas:

- Advertising
- Asset Protection
- Banking and Finance
- Business Reorganization, Bankruptcy and Creditors' Rights
- Corporate, Securities and M & A
- Employment and Labor
- Entertainment
- Healthcare
- Hotel and Hospitality
- Intellectual Property
- International Trade
- Internet/Technology
- Legal Ethics & Law Firm Practice
- Litigation
- Matrimonial and Family Law
- Privacy
- Private Funds
- Promotions
- Real Estate

- Income Tax
- Trusts and Estates

The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
Tel: 212.554.7800 Fax: 212.554.7700

2200 Fletcher Avenue
Fort Lee, NJ 07024
Tel: 201.363.1210 Fax: 201.363.9210
Abraham Y. Skoff, Esq.
Managing Attorney for New Jersey