

SEC Adopts Proxy Access Rules

September 2010

On August 25, 2010, the Securities and Exchange Commission (the "SEC") adopted new rules (i) giving shareholders the right, in situations where they are permitted to nominate directors under state law and company governing documents, to require a company to include in its proxy statement such shareholders' nominees for director (new Rule 14a-11), and (ii) giving shareholders the right to require a company to include in its proxy statement shareholder proposals to establish broader, more flexible proxy access procedures and rights (amended Rule 14a-8).

The rules follow from the SEC's June 2009 proposed rules on this topic, as discussed in our update titled "SEC Seeks to Expand Director Nomination Process", which can be found at http://www.burnslev.com/apps/uploads/publications/SEC_Expand_Director_Nomination_July09.pdf.

This update provides an overview of the most significant rule changes pertinent to director nominations and proxy statements, but the full text of the 451-page SEC Release nos. 33-9136 and 34-62764 can be found at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

The release states that the SEC adopted the rules "to facilitate the effective exercise of shareholders' traditional state law rights to nominate and elect directors to company boards of directors." In addition to creating greater accountability and responsiveness to shareholder interests, the rules are expected to "potentially improve overall board and company performance" and "result in more informed voting decisions in director elections," according to the SEC.

Many public commentators proposed during the rule-making period that companies should be able to "opt in" or "opt out" of the new rules, but the SEC explicitly rejected that notion, asserting that "[i]n the realm of corporate governance, some rights cannot be bargained away."

Some commentators also lobbied for complete or partial exclusion of investment companies from the rules, but those proposals were explicitly rejected as well.

The new rules were published in the Federal Register on September 16, 2010 (several weeks later than anticipated) and therefore will become effective 60 days later, on November 15, 2010. Given the window period requirements for submission of shareholder nominees as noted below, some companies will be subject to the new rules for the Spring 2011 proxy season while others will not be subject until 2012.

SHAREHOLDER NOMINEES: NEW EXCHANGE ACT RULE 14A-11

Prior to the new rules, a stockholder that wanted to propose a nominee to be included in the company's proxy materials generally could not require the company to do so; if the company refused, the stockholder had to launch a proxy contest, which required the stockholder to prepare, distribute and pay for its own proxy materials. The new rules make things easier for stockholders.

New Rule 14a-11 provides guidelines concerning: (1) when the rule is and is not applicable; (2) the companies to which it applies; (3) the shareholders or groups who are eligible to use it; (4) the director nominees who are eligible to use it; (5) the maximum number of nominees required to be included in a company proxy; (6) the priority for proxy inclusion when there are too many eligible nominees; (7) the required notices associated with the process for accessing the company proxy statement; (8) the requirements in responding to notices; (9) the application of proxy solicitation rules to nominating shareholders; and (10) certain 2011 proxy season transition issues.

1. When Rule 14a-11 Will Apply

A public company will be subject to the new rules for providing access to company proxy materials unless applicable state or foreign

law (for foreign issuers) or company governing documents prohibit shareholders from nominating director candidates.

In situations where applicable state or foreign law or company governing documents provide director nomination procedures that are more permissive than Rule 14a-11 in some respects and more restrictive in others, a shareholder or group will not be able to "pick and choose" different aspects of different procedures. In such an instance, a shareholder or group that wants to nominate a director must clearly indicate which procedure they are electing to follow and then meet all of the requirements of that procedure.

Shareholders will also still be allowed to engage in traditional proxy contests involving control of a company or its board, but will, as historically been the case, have to incur the costs of launching a proxy contest and preparing and distributing their own proxy materials. However, a nominating shareholder or group that relies upon the new rules to engage in exempt solicitations would lose the exemption if they also engage in a traditional proxy contest or solicitation.

2. Companies Which Are Subject to Rule 14a-11

New Rule 14a-11 will apply to all public companies that are subject to the Exchange Act proxy rules, including investment companies registered under the Investment Company Act of 1940. The new rule will not apply, however, to companies that are subject to the proxy rules solely because they have a class of debt that is publicly registered pursuant to Section 12 of the Exchange Act.

For smaller reporting companies (generally, issuers with a public float of less than \$75 million), Rule 14a-11 will become effective November 15, 2013, three years after the date that the rules become effective for all other public companies.

3. Who Can Use Exchange Act Rule 14a-11

Rule 14a-11 is available only to those shareholders who hold a significant, long-term interest in a company, have no intent to exercise a change in control, and provide the requisite notice of intent to use the rule (as described below). More specifically, the rule requires that shareholders seeking its benefits and protections must meet the following qualifications:

3a. Required Ownership Thresholds

A nominating shareholder or group will be required to hold, as of the date of providing shareholder notice on new Schedule 14N, at least three percent of the voting power of the company's securities that are entitled to be voted at the shareholder meeting in question.

The SEC noted that roughly 33 percent of both large, accelerated filers and smaller, non-accelerated filers do have a single shareholder who meets this ownership threshold, so the ownership threshold should not present excessive obstacles to use, but should also not open a floodgate of shareholder nominations.

The nominating shareholder or shareholders must not only hold a class of securities that is subject to the proxy solicitation rules, they must hold both the investment and voting power, either directly or beneficially. Securities that have been loaned by or on behalf of the nominating shareholder(s) can be counted toward the ownership requirement, but only if: (1) the nominating shareholder(s) have the right to recall the loaned securities; and (2) the nominating shareholder(s) will in fact recall the securities upon being notified that any of their nominees will be included in a company's proxy materials.

3b. Required Holding Period

In order to safeguard against shareholders using Rule 14a-11 as a means of gaining company control, the SEC adopted a requirement that nominating shareholders must have held the threshold number of shares (as determined on the notice date) for at least three years prior to any exercise of nomination rights.

Furthermore, the amount of securities held during the three-year period will have to be reduced by the amount of securities of the

same class that are the subject of short positions or are borrowed during the period. Securities loaned to a third party during the period are countable toward the threshold provided that the nominating shareholder(s) held a right of recall during the period.

A nominating shareholder or group must continue to hold the requisite number of shares (as established on the notice date) through the date of the relevant shareholder meeting in order to exercise their rights.

3c. No Change in Control Intent

To rely on Rule 14a-11, the nominating shareholder(s) must not be holding any of the company's securities with the purpose or effect of: (1) changing control in the company; or (2) gaining a number of seats on the board of directors that exceeds the maximum number of nominees the company could be required to include in its proxy statement under the rule. The nominating shareholder or group must also provide a certification to that effect on Schedule 14N.

If a company determines that it can exclude a nominee based on this eligibility condition, it will be required to notify the nominating shareholder(s) of a deficiency in its notice on Schedule 14N and provide an opportunity to respond.

Furthermore, a nominating shareholder or group will have liability for any materially false or misleading certification in Schedule 14N and, conversely, the SEC may take enforcement action against a company that inappropriately excludes nominees under Rule 14a-11.

3d. Agreements with the Company

To prevent the risk of nominating shareholders acting as company surrogates to block legitimate usage of the new rule by others, the SEC will also require that any nominating shareholder(s) will not be eligible to use the rule if there is any agreement between the shareholder(s) and the company regarding nominations.

3e. Meeting Attendance and Resubmission of Nominees

While some commentators argued for requirements that any nominating shareholder(s) should attend the pertinent shareholder meeting, the SEC explicitly rejected any such requirements. A proposal

to make nominating shareholder(s) ineligible to use the new rules for a period of time after a failed nomination was also considered and rejected.

4. Director Nominee Eligibility

Under Rule 14a-11, a nominee will not be eligible for inclusion in a company's proxy materials if the nominee's candidacy for or service on the board would violate federal law, state law or applicable exchange requirements, and such violation (such as an independence qualification) could not be cured during the time provided for correction (14 days).

The rule will not prevent a nominee from having to meet the independence criteria for sitting on board committees, and a company may include disclosure in its proxy materials advising shareholders that nominees might not meet the company's subjective criteria for any aspect of their service as a board member (such as serving on committees).

The SEC also rejected proposed requirements that the nominating shareholder(s) must be independent from the director nominees, noting that all directors are subject to state law fiduciary duties to their companies.

5. Maximum Number of Nominees in Company Proxy Materials

In general, a company will not be required to include in its proxy materials any more than one nominee from the shareholder(s), or the number of nominees in total that represent 25 percent of the company's entire board, whichever is greater.

However, where shareholders already have the right to elect a subset of the full board, the maximum number of nominees that a company may be required to include shall not exceed the number of director seats that the class of shares held by nominating shareholders is already entitled to elect.

6. Priority for Multiple Nominations Received by a Company

After consideration of public comments, the SEC revised its proposal to prioritize the "first in time" nominations among multiple groups of nominating shareholders. Thus, a company will be required first to include in its proxy materials the nominee or nominees of the nominating shareholder group with the highest qualifying voting percentage.

If a nominating shareholder or group withdraws or is disqualified after the company provides notice of its intent to include specific nominees in its proxy materials, then the company will be required to include in its materials the nominee(s) of the eligible shareholder group with the next highest voting power percentage.

7. Notices on Schedule 14N

Rule 14a-11 will require that the nominating shareholder(s) provide a notice on Schedule 14N of intent to require the company to include the nominee(s) of the shareholder(s) in the company's proxy materials. The shareholder(s) will be required to furnish the notice to both the company and the SEC on the same date.

The deadline to provide notice on Schedule 14N is within a 30-day window - *no later than* 120 calendar days prior to the current anniversary of date of mailing for last year's proxy materials but *no earlier than* 150 calendar days prior to that date.

Pursuant to public comments, the SEC expanded the requirements of Schedule 14N beyond its proposed dimensions. Schedule 14N will require the nominating shareholder(s) to provide the following information and statements:

- The name and address of the nominating shareholder(s);
- The amount and percentage of voting securities held by the nominating shareholder(s) and the voting power derived from securities that have been loaned or sold in a short sale that remains open, as defined in Rule 14a-11(b)(1);
- A written statement from the registered holder of shares held beneficially by the nominating shareholder(s) verifying that, within seven calendar days prior to submission of Schedule 14N, the shareholder(s) continuously held the current qualifying amount for at least three years;
- A written statement of the nominating shareholder or group of its intent to continue holding the qualifying amount of securities through the relevant shareholder meeting date for

elections (along with a statement of intent about continued ownership thereafter);

- A statement that each nominee consents to be named in the company's proxy statement and proxy form, and consents to serve on the board if elected;
- Disclosures about the nominee(s) as required in Items 4(b), 5(b), and 7(a)-(c) of Schedule 14A (and Item 22(b) for investment companies), such as name, business experience, securities ownership, and related party transactions with the company;
- Disclosure about the nominating shareholder(s) as required by Items 4(b) and 5(b) of Schedule 14A (as provided for in contested elections);
- Disclosure about whether the nominating shareholder(s) and/or nominee(s) have been involved in any legal proceeding within the last 10 years, as specified by Item 401(f) of Regulation S-K;
- Disclosure about whether, to the best of the nominating shareholder's or group's knowledge, the nominee(s) meet the director qualifications set forth in the company's governing documents;
- A statement that to the best of the nominating shareholder's or group's knowledge, the nominee(s) meet the objective criteria for "independence" of the national securities exchange or national securities association rules applicable to the company (or the "interested person" rules of the Investment Company Act);
- Disclosures about the nature and extent of specified relationships, commercial interests and/or litigation between the nominating shareholder(s), the nominee(s), and/or the company or its affiliates;
- Disclosure of any website address on which the nominating shareholder(s) may publish soliciting materials; and, if desired for inclusion in the proxy materials; and

- A statement or statements of less than 500 words in support of each nominee.

Any nominating shareholder(s) also must certify on Schedule 14N that they have no change of control intent or intent to gain more than the maximum number of board seats provided for in Rule 14a-11.

8. Requirements for Companies Receiving Schedule 14N Notices

If a company decides to include a shareholder nominee in its proxy materials for the reasons described below, it must notify the nominating shareholder(s) of that decision in writing. The written notice must be postmarked or transmitted electronically no later than 30 calendar days prior to the company filing of a definitive proxy statement and form of proxy with the SEC.

On the other hand, if a company decides to exclude a shareholder nominee, it will be required to provide notice to the SEC regarding its determination that the nominee can be lawfully excluded. The company may also seek a no-action letter from the SEC regarding the exclusionary decision.

A company that excludes a shareholder nominee will also be required to notify the nominating shareholder(s) by communication postmarked or transmitted electronically no later than 14 calendar days after the close of the window period for submission of nominations pursuant to Rule 14a-11.

Any response to the company's notice by the nominating shareholder(s) must be postmarked or transmitted electronically no later than 14 calendar days after receipt of the company's notification.

Pursuant to public comments, the SEC has provided in the new rules that the company will only be able to exclude any shareholder nominee for the following reasons:

- Rule 14a-11 is not applicable to the company;
- The nominating shareholder(s) failed to satisfy the eligibility requirements of Rule 14a-11(b); or
- Inclusion of the nominee(s) would result in the company exceeding the maximum number of nominees it is required to include in its proxy materials.

A table of relevant deadlines appears below:

| Action Required | Due Date |
|--|--|
| Nominating shareholder(s) must provide notice on Schedule 14N to the company and file it with the SEC. | No earlier than 150 calendar days and no later than 120 calendar days before the current anniversary of the mailing of last year's proxy materials for the annual meeting. |
| Company must notify the nominating shareholder(s) of any preliminary determination not to include them. | No later than 14 calendar days after the close of the window period for submission of nominations. |
| Nominating shareholder(s) or group must respond to the company's deficiency notice. | Within 14 calendar days after receiving the company's deficiency notice. |
| Company must provide to the SEC notice of intent to exclude nominee(s) and the basis for such exclusion(s). | No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC. |
| Response of nominating shareholder(s) to the company's decisions must be filed with the SEC and the company. | Within 14 calendar days of the receipt by nominating shareholder(s) of the company's notice to the SEC. |
| SEC staff to provide, in its discretion, an informal statement of its views on director nominations or exclusions. | As soon as practicable. |
| Company must provide the nominating shareholder(s) with final notice of inclusion or exclusion. | Promptly following receipt of any SEC informal statement of its views. |

When including a shareholder nominee in the company's form of proxy, the company can identify those nominees posited by the shareholders, and can recommend whether shareholders vote for or against those nominees. The company can also determine the order in which the nominees will appear in the form, but it must otherwise present the nominees in an impartial manner. The SEC explicitly stated that this will prohibit presentation of the company's nominees in such a way that they can be voted on as a block because that could facilitate greater voting for the company's slate of directors.

9. Application of Proxy Solicitation Rules to Nominating Shareholder(s)

New Rule 14a-2(b)(7) provides an exemption from the proxy solicitation rules for written or oral solicitations by or on behalf of any shareholder in connection with the formation of a nominating shareholder group.

Furthermore, exempted written communications may include no more than:

- A statement of the shareholder's intent to form a nominating group in

order to nominate a director pursuant to Rule 14a-11;

- A brief statement regarding the potential nominee(s) or the desired characteristics of the potential nominee(s) that the shareholder(s) intend to nominate;
- A statement of the percentage of voting power of the company's securities that are entitled to be voted that each soliciting shareholder holds (or the aggregate percentage held by any group to which the shareholder belongs); and
- A statement of the means by which shareholders may contact the soliciting party.

The SEC also created a new Rule 14a-2(b)(8) to facilitate communications among shareholders at any time after a company has given notice that it will include a shareholder nominee in its proxy materials.

This rule provides an exemption from the generally applicable proxy solicitation rules

for all solicitations by or on behalf of a nominating shareholder or group, provided that:

- The soliciting party does not during solicitation seek (for itself or for another) the power to act as proxy for any shareholder and does not furnish or request any form of revocation, abstention, consent or authorization;
- Each written communication includes: (1) the identity of the nominating shareholder or group and a description of their direct or indirect interests in the company; and (2) a specified, prominent legend advising shareholders about the inclusion of any nominees in a proxy, and the location of relevant proxy information on the SEC Web site; and
- Any soliciting material published, sent or given to shareholders in accord with this exemption must be filed with the SEC in specified formats on Schedule 14N, and with the applicable national securities exchanges for each class of security.

10. Transitional Issues for the 2011 Proxy Season

The new rules become effective November 15, 2010. Given the 30-day window period for filing the Form 14N, companies that mailed their 2010 proxy statement prior to March 15, 2010 would have a window period that closed prior to the November 15, 2010 effective date and therefore will not be subject to the new rules for the Spring 2011 proxy season. Companies that mailed their 2010 proxy statement on or after March 15, 2010 will be subject to the new rules for the Spring 2011 proxy rules.

CHANGES IN GOVERNING DOCUMENTS: EXCHANGE ACT RULE 14A-8(i)(8)

Previously, a company could exclude a stockholder request to include in the company's proxy materials a proposal that related to a particular nominee for election to the Board or to a procedure for such nomination or election. Pursuant to revisions made to Rule 14a-8(i)(8), companies will no longer have absolute discretion to do so.

Under the amended rules, a company will be permitted to exclude such a proposal if:

- It would disqualify a nominee who is currently standing for election;
- It would remove a director from office before his or her term expired;
- It questions the competence, business judgment or character of one or more nominees or directors;
- It seeks to include a specific individual in the company's proxy materials for election to the board of directors; or
- It otherwise could affect the outcome of the current election of directors.

OTHER RULE CHANGES

The SEC announced additional rule changes and changes to its previous proposals pertinent to issues associated with nomination and voting for directors.

1. Disclosure of Dates

If a company failed to hold an annual meeting in the past year, or if the date of the meeting has subsequently changed by more than 30 days from the prior year, then it will be required to file a Form 8-K to disclose the date by which a nominating shareholder or group must submit notice to include any nominees for director in the company's upcoming proxy materials.

2. Beneficial Ownership Reporting

Pursuant to the new rules, nominating shareholders must consider whether they have formed a group subject to Exchange Act Section 13(d)(3) and Rule 13d-5(b)(1), which generally requires the filing of beneficial ownership reports by those owning five percent or more of any class of equity securities of a company.

However, the SEC has adopted changes to the rules and to the certifications in Schedule 13G so that affected shareholders may be able to report their holdings on the less onerous Schedule 13G rather than Schedule 13D, which is intended to call attention to potential changes in control.

3. Nominating Shareholders or Groups as Affiliates

The SEC originally proposed a "safe harbor" rule that would protect nominating shareholders from being deemed as

"affiliates" of the company solely as a result of using Rule 14a-11.

But the safe harbor idea was discarded after review of public comments. The SEC stated that those who use Rule 14a-11 will simply need to analyze the facts and circumstances of each case to determine if they might be affected by regulations pertinent to "affiliates" of the company.

LIABILITY FOR STATEMENTS MADE BY NOMINATING SHAREHOLDERS

New Rule 14a-9(c) provides that "no nominee, nominating shareholder or nominating shareholder group... shall cause to be included in a registrant's proxy materials... or a registrant's governing documents... [nor] include in a notice on Schedule 14N, or include in any other related communication, any statement which... is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any [prior relevant] statement."

Thus, persons utilizing Rule 14a-11 or any other means of nominating directors will be held responsible for any misleading statements or omissions in connection with their shareholder campaign activities.

By contrast, the SEC adopted a separate provision stating that companies will not be responsible for information that is provided by the nominating shareholder, group or nominees under Rule 14a-11 and then repeated in a proxy statement. But if the company incorporates the information by reference or otherwise adopts the information as its own in any of its communications, then that information can be considered as part of the company's own statements for purposes of the anti-fraud and civil liability provisions of the relevant securities laws.

Explanatory Notes:

This update is intended to call your attention to a number of rule changes of possible interest and relevance, but it is not intended to constitute a legal opinion or definitive summary of all changes that could be material to you.

Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these potential rule changes or if you want to learn more about our expertise in this area.

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In the securities compliance area, we advise our clients on corporate governance/Sarbanes-Oxley and SEC and stock exchange reporting and compliance. Specifically, we assist our clients in fulfilling their ongoing SEC and stock exchange reporting obligations, managing sensitive disclosure issues internally and with industry analysts, preparing proxy statements and handling stockholder meetings, structuring employee benefit plans and executive compensation packages under the SEC's "short-swing profit" reporting and liability rules, effecting resales of securities in the public trading markets under

the SEC's Rule 144, and advising boards of directors and board committees concerning the requirements and restrictions imposed on their actions by the securities laws and corporate governance laws such as Sarbanes-Oxley. We have served as special securities counsel to the Boards and Audit Committees of publicly traded companies looking for opinions or advice of counsel other than their regular outside counsel.

We have counseled clients both domestic and international, from emerging growth companies to large public companies, and are positioned to provide clients with timely, expert, efficient and cost effective advice that they need to meet their business objectives. We take a practical and proactive approach to the rapidly changing securities disclosure and corporate governance laws, providing our clients with timely updates, identifying specific situations in which the new laws will impact particular clients either operationally or structurally, and working with clients to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

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Our attorneys also represent underwriters in initial and follow-on public offerings and investment banks in private placements and mergers and acquisitions.