

Clients & Friends Memo

Recent Amendments to Rule 14a-8 and the Implications for the 2012 Proxy Season

September 28, 2011

This memorandum discusses recent amendments to Exchange Act Rule 14a-8 that will require companies to include in their proxy materials, under certain circumstances, shareholder proposals that seek to establish a procedure for shareholders to include director nominees in the company's proxy materials. This memorandum also identifies certain actions companies should consider for the 2012 proxy season.

Background

On September 20, 2011, amendments to Rule 14a-8 and certain related rules and amendments became effective upon publication in the Federal Register.¹ Under the amendments to Rule 14a-8, as discussed in more detail below, companies will no longer be able to exclude from their proxy materials shareholder proposals that seek to establish a procedure for shareholders to nominate directors.

While the amendments to Rule 14a-8 will facilitate greater shareholder access to a company's proxy statement, the changes are more limited than the "proxy access" changes originally proposed by the Securities and Exchange Commission (the "**SEC**"). In 2010, the SEC adopted Rule 14a-11, which required companies, under certain circumstances, to include shareholder nominees for

¹ See Release Nos. 33-9259; 34-65343; IC-29788 (available at <http://www.sec.gov/rules/final/2011/33-9259.pdf>). The related changes to certain other rules and regulations include the addition of a new Rule 82a, 14a-18, Regulation 14N and Schedule 14N, and amendments to Rule 13 of Regulation S-T, Rules 13-a-11, 13d-1, 14a-2, 14a-4, 14a-5, 14a-6, 14a-9, 14a-12, 15d-11, Schedule 13G and Schedule 14A. Such changes include, among other things, new disclosure requirements that apply to shareholders that are relying on a procedure under state or foreign law or a company's governing documents to include a nominee in the company's proxy materials, and changes to communication between shareholders in the proxy process, existing solicitation exemptions from the proxy rules and the beneficial ownership reporting requirements.

director in company proxy materials.² However, prior to Rule 14a-11 becoming effective, the Business Roundtable and the U.S. Chamber of Commerce filed a petition (the “**Business Roundtable Petition**”) with the U.S. Court of Appeals for the District of Columbia Circuit (the “**D.C. Circuit**”) challenging the new Rule 14a-11. In an order dated October 4, 2010, the SEC stayed the effective and compliance dates of the amendments to the proxy rules, including Rule 14a-8, until the resolution of the Business Roundtable Petition.³ On July 22, 2011, the D.C. Circuit issued an order vacating Rule 14a-11,⁴ and, on September 6, 2011, the SEC confirmed that it would not seek a rehearing of the decision.⁵ With the Business Roundtable Petition resolved, the SEC’s stay was lifted and the amendments to Rule 14a-8 and certain related rules and amendments became effective on September 20, 2011.

Amended Rule 14a-8

Prior to amendment, Rule 14a-8(i)(8) permitted companies to exclude from their proxy materials shareholder proposals that related to a nomination or an election for membership on a company’s board of directors or analogous governing body or a procedure for such nomination or election. Under amended Rule 14a-8(i)(8), the “election exclusion” is narrowed, which, in turn, permits qualifying shareholders to submit proposals (that are not otherwise excludable) that seek to establish a procedure for shareholders to include director nominees in company proxy materials.

As amended, Rule 14a-8(i)(8) provides that a company may rely on the following bases to exclude a shareholder proposal:

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- ² As adopted, Rule 14a-11 required that shareholders seeking to have their nominee included in a company’s proxy materials meet the following eligibility requirements:
- Own at least 3 percent of the total voting power of the company’s securities that are entitled to be voted on the election of directors at the annual meeting;
 - Have held their shares for at least three years and continue to own at least the required amount of securities through the date of the meeting at which directors are to be elected; and
 - Such shareholders are not holding the securities for the purpose of changing control of the company, or to gain a number of seats on the board of directors that exceeds the number of nominees a company is required to include under Rule 14a-11.
- ³ See Release Nos. 33-9149, 34-63031, and IC-29456 (available at <http://www.sec.gov/rules/other/2010/33-9149.pdf>).
- ⁴ See *Business Roundtable v. SEC*, No. 10-1305, slip op. (D.C. Cir. Jul. 22, 2011) (available at [http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf)).
- ⁵ See Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation (available at <http://sec.gov/news/press/2011/2011-179.htm>).

(8) **Director Elections:** If the proposal:

- i. Would disqualify a nominee who is standing for election;
- ii. Would remove a director from office before his or her term expired;
- iii. Questions the competence, business judgment, or character of one or more nominees or directors;
- iv. Seeks to include a specific individual in the company's proxy materials for election to the board of directors; or
- v. Otherwise could affect the outcome of the upcoming election of directors.

Rule 14a-8(i)(8) is thus significantly narrowed and companies may no longer exclude a proposal merely because it relates to the nomination or election of directors or proposes a procedure for nomination or election.

The current eligibility provisions of Rule 14a-8 will continue to apply. In order to be eligible to submit a proposal, under Rule 14a-8(b), a shareholder must have continuously held at least \$2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date the shareholder submits the proposal.

The amendments to Rule 14a-8(i)(8) are in line with recent revisions to certain state corporate codes that provide for greater shareholder access to companies' proxy statements. For example, in 2009, certain amendments were made to the Delaware General Corporation Law (the "*DGCL*") that permit companies to adopt bylaws that provide for shareholder access to company proxy materials for the purpose of proposing director nominees. The 2009 amendments to the *DGCL* added a new Section 112 that provides authority for a bylaw requiring a Delaware corporation to include stockholder-proposed nominees for director in the corporation's proxy materials under certain circumstances. It should be noted that Section 112 also includes a nonexclusive list of permissible procedures and conditions that may be put in place in a company's bylaws to limit stockholder access, which procedures or conditions may include any of the following:

1. A provision requiring a minimum record or beneficial ownership, or duration of ownership, of shares of the corporation's capital stock, by the nominating stockholder, and defining beneficial ownership to take into account options or other rights in respect of or related to such stock;
2. A provision requiring the nominating stockholder to submit specified information concerning the stockholder and the stockholder's nominees, including information

- concerning ownership by such persons of shares of the corporation's capital stock, or options or other rights in respect of or related to such stock;
3. A provision conditioning eligibility to require inclusion in the corporation's proxy solicitation materials upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require such inclusion;
 4. A provision precluding nominations by any person if such person, any nominee of such person, or any affiliate or associate of such person or nominee, has acquired or publicly proposed to acquire shares constituting a specified percentage of the voting power of the corporation's outstanding voting stock within a specified period before the election of directors;
 5. A provision requiring that the nominating stockholder undertake to indemnify the corporation in respect of any loss arising as a result of any false or misleading information or statement submitted by the nominating stockholder in connection with a nomination; and
 6. Any other lawful condition.

In addition, in 2007, North Dakota amended its corporate code to permit, among other things, shareholders who have owned at least 5% of a company's stock for at least two years to provide a company notice of intent to nominate directors and require the company to include each such shareholder nominee in its proxy statement and form of proxy. Following North Dakota's passage of shareholder friendly corporate laws, activist investors submitted proposals to several companies seeking reincorporation to North Dakota by such companies.

2012 Proxy Season Considerations

As a result of the amendments, companies will no longer be able to rely on Rule 14a-8(i)(8) to exclude a proposal seeking to establish a procedure for shareholders to include director nominees in their proxy materials. Therefore, companies should be prepared to address these shareholder proposals in the upcoming 2012 proxy season and should consider the following:

- **Consider Being Proactive.** Some companies may want to proactively address the issue and demonstrate responsiveness to shareholder concerns. Those companies should consider including a proposal in their proxy statement setting forth procedures for shareholders to include director nominees in the company's proxy materials. This would allow the company to define the terms of the proposal. If a company were to include such a proposal in its proxy materials, any shareholder proposal relating to this same topic could potentially be excludable pursuant to

14a-8(i)(9) as a proposal that conflicts with one of the company's own proposals.⁶ Many companies took similar proactive steps when majority voting standards for director elections became prevalent, which allowed those companies to effectively set certain standards for director elections. Of course, it is far from certain whether such a private ordering will materialize for proxy access issues. If a company decides not to submit its own proposal, it should be prepared to respond to similar proposals from its shareholders.

- **Communicate with Shareholders.** Companies should consider engaging their significant shareholders about stockholder proposals concerning proxy access. An open line of communication between a company and its largest shareholders can help ensure that any issues are addressed in a timely manner and further demonstrate that a company is responsive to its shareholders concerns.
- **Review Current Bylaw Provisions.** Companies may also want to consider reviewing their advance notice bylaws and, if directors have the power to amend the bylaws, companies should consider whether their current requirements for shareholder proposals and director nominations are comprehensive and whether any additional information is necessary or prudent.
- **Review Voting Guidelines Set by Proxy Advisory Services.** Companies will want to review the 2012 voting guidelines issued by the influential proxy advisory services. ISS's 2011 proxy voting guidelines provided that ISS would vote on a case-by-case basis on shareholder proposals asking for open or proxy access, taking into account (i) the ownership threshold proposed in the proposal and (ii) the proponent's rationale for the proposal at the targeted company in terms of board and director conduct. It would not be unexpected if the proxy advisory services issued guidelines supporting, to varying degrees, proposals seeking shareholder access to companies' proxy statements for director nominations, much as they have supported prior proposals seeking to provide shareholders with a greater participation in companies' governance, including majority voting, "say on pay", golden parachute and independent chairman proposals.

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⁶ Alternatively, if permitted by the company's bylaws, the board could also amend the bylaws to provide procedures for shareholders to include director nominees in the company's proxy materials. The company could potentially seek no-action relief from the SEC to exclude shareholder proposals on the same issue pursuant to Rule 14a-8(i)(10) on the basis that such proposals are already substantially implemented by the company. However, there is no certainty that proposals setting forth different eligibility criteria may be excluded on this basis.

Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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