MORROW & CO., LLC
Proxy Update

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Rational and Balanced or Fundamentally Flawed? SEC Approves Proxy Access Rules

Capping, but certainly not ending, years of debate, the SEC this week voted at an open meeting to approve final rules allowing for Proxy Access. The vote was along party lines and the disagreement about the rules at the Commission appears to run deep. At the meeting, the same rules were referred to as “rational, balanced and necessary” by the Chairman, and "fundamentally and fatally flawed" by one of the Commissioners. Notwithstanding internal SEC dissension and expected challenges by lobbyists, the rules will be in place for the 2011 meeting season, necessitating preparation now.

Below is a brief summary of some of the key aspects of the rules to answer the “big picture” questions. In the coming weeks, we will delve into the details and provide you with additional commentary and advice on the functional impact of the rules.

Critical Aspects of the Rules

- **Effective date and impact date.** 14a-11 will be effective 60 days from publication in the Federal Register. If the publication is next week (as expected), the rule could be effective November 1. And given the advanced notice requirement of the rule (discussed below), companies that mailed proxy material on March 1, 2010 or later would be vulnerable to proxy access.
- **Companies subject to the rule.** New Rule 14a-11 will apply to companies that are subject to the Exchange Act proxy rules, including investment companies registered under Section 8 of the Investment Company Act of 1940, and controlled companies.
- **Smaller reporting companies are exempt for 3 years.** Companies with a public float of less than $75,000,000 will be exempt for 3 years.
- **Issuers can’t “opt out”.** Issuers may not seek shareholder approval to opt out either in favor of a different framework or no framework.
- **There is no triggering event.** In an earlier SEC proposal, a company may have been subject to Proxy Access after one or two triggering events, such as a withhold vote of 35% or more on directors. The triggering event criteria has been eliminated.
- **3 Years and 3 Percent:** To be able to use rule 14a-11, a nominating shareholder must have held 3% of the voting power of the company’s securities **continuously** for 3 years. The holder must also hold both investment and voting power. This is a change from the proposed release which had ownership requirements of 1%, 3%, or 5%, depending on market capitalization.

- **Shareholders can aggregate their holdings.** Shareholders can aggregate their holdings in order to achieve the 3-and-3 threshold. However, it is important to note that in the case of a nominating group, the shares that each member of the group is contributing to satisfy the 3% ownership requirement must have been held continuously for at least 3 years. This is likely to preclude most hedge funds and many activists from using 14a-11, limiting the pool of potential candidates that were hoping to use 14a-11 as a way of pressuring boards.

  Forming a nominating group will not in and of itself trigger a requirement to file under Exchange Act Section 13(d). In addition, activities solely in connection with the nomination process under 14a-11 would not make a shareholder ineligible to continue reporting on Schedule 13G.

- **Shares on loan would count, borrowed shares would not.** Shares that have been loaned by the nominating shareholder may be counted toward the ownership requirement as long as the holder has the right to recall the loaned securities; and will recall the loaned securities upon being notified that any of the nominees will be included in the company's proxy materials. The rule explicitly excludes borrowed shares.

- **The nominating shareholder must hold through the date of the meeting, and make a statement as to its intended ownership after the meeting** (which may be contingent on the results of the election of directors).

- **Uniform advanced notice window of 30 days - 150 to 120 calendar days prior to the anniversary of the mailing of the prior year's proxy statement**. Rule 14a-11 contains a window period for submission of shareholder nominees for inclusion in company proxy materials of no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting.

- **Largest holder, not first-in, gets the nod**. The nominating shareholder with the highest percentage of the company's voting power would have its nominees included in the company's proxy materials. The first-in standard that was in the proposed rules has been eliminated.

- **Limit of one nominee or 25% of the board.** A nominating shareholder would be limited to nominating directors that would make up 25% of the board or one seat, which ever is greater. On a staggered board, you would count the entire board.

  In the event that the largest holder does not nominate the maximum number of directors, the nominating shareholder with the next highest qualifying voting power percentage would be included in the company's proxy.

- **Replacement nominees acceptable if the nominating shareholder withdraws or is disqualified.** If a nominating shareholder were to withdraw or is disqualified after the company provides notice to the nominating shareholder of the company's intent to include the nominee or nominees in its proxy materials, the company will be required to include in its proxy statement the nominee or nominees of the nominating shareholder or group with the next highest voting power percentage.

- **Nominees do not need to meet the company's director qualification requirements.** A company could not exclude nominees who do not meet any director qualification requirements imposed by the issuer. However, a nominating shareholder would need to disclose whether, to the best of their knowledge, the nominating shareholder's nominee meet the company's director qualifications.
- **Nominating shareholder can't seek control**. A nominating shareholder must provide a certification in its Schedule 14N that it is not seeking a change of control of the company or gaining more than the number of seats on the board allowed under the rule.
- **No limit on resubmission of 14a-11 in unsuccessful.** A shareholder's ability to use 14a-11 would not be impacted by prior unsuccessful nominations under the rule.
- **Companies can't exclude a 14a-8 proposal on proxy access; nor can a shareholder file a 14a-8 proposal to remove 14a-11 proxy access.** 14a-8 has been amended to preclude companies from relying on 14a8-(i)(8) to exclude shareholder proposals that could require different ownership thresholds, holding period, or other qualifications than those in 14a-11. In addition, a shareholder proposal seeking to limit or remove the availability of Rule 14a-11 would be subject to exclusion under Rule 14a-8.
- **14a-11 will apply regardless of whether the company is subject to a concurrent proxy contest under 14a-12(c).**
- **14a-11 would be available even if state law allows for proxy access**. Rule 14a-11 will continue to be available to shareholders regardless of whether they also can avail themselves of a provision under state law.
- **14a-11 trumps a company's governing documents.** For example, if the company has a 10% holding requirement to nominate, the lower 3% threshold under 14a-11 would apply.
- **Form of proxy**.
    - **Company can make a recommendation.** The company's form of proxy could identify the shareholder nominees as such and recommend whether shareholders should vote for, against, or withhold votes on those nominees and management nominees on the form of proxy.
    - **Company can determine the order of listing management and dissident nominees.** The company can determine the order in which its nominees and any shareholder nominees are listed in the form of proxy. The company would otherwise be required to present the nominees in an impartial manner in accordance with Rule 14a-4.
    - **No option to vote for nominees as a group.** A company may not give shareholders the option of voting for or withholding authority to vote for the company nominees as a group, but instead must require that shareholders vote on each nominee separately.

- **Nominating shareholder can't furnish their own proxy**. Nominating shareholders would not be able seek the power to act as a proxy, furnish a form of revocation, or send out their own proxy card.
- **No preliminary proxy statement**. A company would not be required to file a preliminary proxy statement in connection with a nomination made pursuant to Rule 14a-11.

With the filing of the final rules, many questions have been answered, but new ones will need to be answered. We will continue to review the new rules and provide you with commentary, guidance, and advice. In the meantime, if you have any questions please call or email your Morrow contact or you can call Fred Marquardt, Tom Ball or John Ferguson at 203-658-9400.

If you would like a copy of the rule it can be found at:
http://www.sec.gov/rules/final/2010/33-9136.pdf.

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