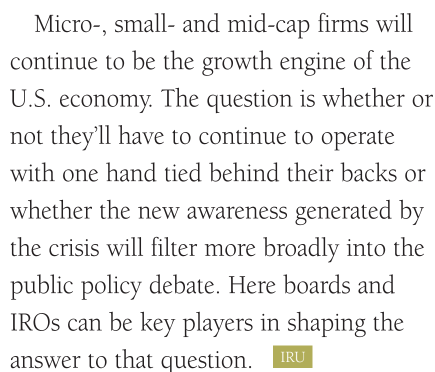
Because board memberships do not change quickly, IROs have an important role to play in helping to educate the board on the particular governmental issues facing the firm and the way in which those issues play out with the investor community. In addition, IROs need to educate the board on the way in which the current crisis has changed the prospects for investor activism and investor composition.



Micro-, small- and mid-cap firms will continue to be the growth engine of the U.S. economy. The question is whether or not they'll have to continue to operate with one hand tied behind their backs or whether the new awareness generated by the crisis will filter more broadly into the public policy debate. Here boards and IROs can be key players in shaping the answer to that question. IRU

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IROs and the Proposed Proxy Access Rules

BY LOIS YUROW

Third time's a charm? On May 20th, the Securities and Exchange Commission voted to propose rules that would enable public company shareholders to nominate a limited number of directors without mounting a proxy contest. The SEC has considered "proxy access" twice already this decade and declined to adopt rules to make it a reality. (See my September 2007 *IR Update* article, *SEC Offers Competing Proxy Access Proposals for Public Reaction*.) The political climate may now be ripe for proxy access to prevail.

The SEC's proposal is simple in concept, but laden with details. Generally, proposed new Rule 14a-11 would allow shareholders that meet prescribed ownership thresholds and that do not aspire to change control of the company to nominate candidates for up to 25 percent of the board, or a minimum of one director. In addition, Rule 14a-8 would be amended to permit shareholder proposals to alter company by-laws to facilitate shareholder nominations. (See sidebar.)

Who Can Nominate Candidates, and How?

The SEC proposes three requirements for shareholders who would rely on Rule 14a-11.

First, a nominating shareholder must satisfy an ownership threshold, which will vary depending on the size of the company. Amendments to the proxy solicitation rules would permit shareholders to join together to attain the ownership thresholds.

The proposed ownership thresholds are:

- For companies with a public float of $700 million or more: one percent;
- For companies with a public float between $75 million and $700 million: three percent;
- For all other companies: five percent.

In each case, the stock must have been held continuously for one year. The SEC estimates that most public companies would have at least one shareholder or group of two shareholders that could nominate directors with these ownership thresholds.

Second, the SEC has proposed a new form — Schedule 14N — that nominating shareholders would provide to the company and file with the Commission. Schedule 14N requires information about each nominating shareholder's stock ownership, assurance that no nominating shareholder is attempting to change control of the company, and (generally speaking) the information about each nominating shareholder and nominee that is currently required in a contested election.

Third, nominating shareholders must follow a prescribed timetable. The company must receive Schedule 14N by the date established in the company's advance notice provision or, in the absence of an advance notice provision, by 120 days before the anniversary of the mailing date for the prior year's proxy materials. (This deadline is adjusted if the company did not have a meeting the prior year or changes the meeting date by more than one month.)

What Happens When a Company Receives Shareholder Nominations?

A company that receives one or more timely nominations should first evaluate whether 1) each nominating shareholder is eligible to submit nominations, 2) each nominee is eligible to become a director, and 3) each Schedule 14N is accurate and complete. For example, a nominee may have a criminal record that disqualifies him or her from service on a public company board. If there is no permissible reason to bar a nominee, the company must notify the nominating shareholder that the nominee will be included in the proxy statement.

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If a company receives nominations for more than 25 percent of the board (considering existing board members who were shareholder nominees), the nominations on the first complete Schedule 14N to be filed have priority. If that Schedule 14N contains too many nominations, the submitting shareholders are entitled to decide which nominees to eliminate.

The "first to file" proposal is contentious. Previous proxy access proposals would have given priority to the largest shareholder to submit nominations, not the fastest. There are concerns that shareholders will act quickly — perhaps before completely analyzing what the company needs and who the best possible directors might be.

A company that believes a nominating shareholder or nominee is not eligible under Rule 14a-11 must explain the defect in writing. The nominating shareholder then has an opportunity to cure (or explain away) the problem, but cannot do so by changing the nominating group or the nominee(s). If there is still a dispute about a particular nomination, the procedure for appealing to the SEC is similar to the procedure now used when a company wishes to exclude a shareholder proposal.

Lois Yurow

PROPOSED AMENDMENTS TO RULE 14A-8

In 2007, the SEC amended Rule 14a-8(i)(8) to clarify that a company may exclude a shareholder proposal that relates to a nomination or election for the board or "a procedure for such nomination or election." That amendment was designed to prevent shareholders from gaining proxy access company by company.

The proposed amendments to Rule 14a-8 would *reverse* the SEC's 2007 action by narrowing the "election exclusion" so that companies could only omit proposals that:

- Would disqualify a particular nominee
- Would remove a director from office before the end of her term
- Question the competence, judgment, or character of any nominee(s) or director(s)
- Nominate a specific individual for the board without complying with applicable law, rules, or by-laws
- Could otherwise affect the outcome of the upcoming election

If Rule 14a-8 is amended as proposed, any public company could end up with proxy access standards that differ from the standards at other public companies, and that differ from (but don't conflict with) Rule 14a-11. Companies would not be permitted to amend their by-laws to impose stricter eligibility standards than those in Rule 14a-11. Some commentators argue that the SEC's proposed amendments intrude into an area of the law that should be left to individual companies and the states.

What Will the Proxy Look Like With Shareholder Nominations?

A proxy statement that includes Rule 14a-11 shareholder nominees will differ from current proxy statements in two noticeable ways.

First, nominating shareholders may provide a 500-word statement in support of their candidates to be included in the company proxy. The company may elect to provide a statement explaining why it opposes particular candidates.

Second, with a typical company proxy, shareholders can vote for an entire slate of directors as a group. In an election with Rule 14a-11 nominees, shareholders must vote on each candidate individually.

Can Shareholders Solicit for Their Nominees?

Shareholders would be able to use a Web site, electronic shareholder forum, or other means to solicit votes for their nominees once the proxy statement is available. In general, a solicitation that does not seek proxy authority, and merely introduces the nominating shareholders and explains that the proxy statement contains one or more shareholder nominees, will be permissible.

What Happens Next?

IROs are familiar with the arguments for and against proxy access. Shareholder advocates find it unfair that a public company can use corporate assets to produce a proxy statement promoting a slate of board candidates and to solicit votes for that slate, while shareholders need to spend their own money to promote alternatives. Conversely, many business interests worry that shareholder-nominated directors will be beholden to special interests, that a company that needs to make room on its ballot for such directors will suffer the distractions of a proxy contest with every election, and that qualified candidates chosen by the company will decline to run because of the hassle (and the risk of losing).

Until now, the "no access" proponents had the upper hand, but the SEC's new chair believes that shareholders — particularly after suffering through this economic downturn — deserve more of a say in corporate elections. If proxy access becomes a reality, IROs may find it useful to proactively consult with shareholders about board candidates to try to forestall shareholder nominations, much the same as companies try to avoid shareholder proposals.

The SEC proposing release poses hundreds of questions. In addition to the overarching concern of whether proxy access should be mandated at all, here are some of the issues comment letters are likely to address:

- Are the proposed ownership thresholds reasonable?
- Should the first-to-file get preference over a shareholder with more substantial holdings?

• How would Rule 14a-11 interact with company by-laws that impose different standards for proxy access?

• How would Rule 14a-11 operate in the event of a proxy contest?

• Will majority voting work when there are more candidates than seats?

IROs should watch for the SEC to adopt some form of proxy access before start of the 2010 proxy season. IRU

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PRESIDENT'S NOTE

continued from page 2

a company slate of directors on the proxy, and questions regarding the candidate selection process for the shareholder-nominated twenty-five percent of director nominees.

Say-on-Pay

An advisory vote on Say-on-Pay has been federally mandated for TARP companies and the SEC recently released proposed guidelines for implementation. These guidelines are currently in the midst of a sixty day comment period. If federal legislation passes to make an advisory say-on-pay vote mandatory for all companies, then expect these rules to become effective for everyone.

All of the changes mentioned have an impact on the governance of public companies and only time will show us how onerous and costly the changes will become. Regardless, these changes mean the relationship between company and investor must continue to evolve. Transparent and consistent information is the hallmark of a good investor relations program. Being responsive and credible is the hallmark of a good investor relations professional. As we move into this changing governance environment, two way communications with investors will become even more critical. IR will be on the front lines gathering information from investors, as well as communicating company insight. Highly capable investor relations professionals, who include in their IR toolkit an expanded understanding of their company's governance, will increase their stature within their organizations and continue to elevate the profession.

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