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SEC ADOPTS SHAREHOLDER PROXY ACCESS RULES

On August 25, 2010, the Securities and Exchange Commission ("SEC") adopted new Rule 14a-11 under the Securities Exchange Act of 1934 (the "Exchange Act"). The new rule requires public companies to permit any shareholder or group of shareholders owning at least 3% of the public company's voting stock for at least three years to include director nominees in the company's proxy materials. In addition, the SEC amended Exchange Act Rule 14a-8 to require public companies to include in their proxy materials qualified shareholder proposals relating to adoption of a shareholder access regime under the company's governing documents, provided such proposals do not conflict with or limit the mandatory provisions of Rule 14a-11. A copy of SEC Release No. 33-9136 adopting the rule and related amendments is available online here.

Application and Effectiveness of New Rule 14a-11

The proxy access rules will apply to all Exchange Act reporting companies, including investment companies. The rules do not apply to foreign private issuers and companies subject to SEC reporting solely because they have a class of registered debt securities. The rules will be effective 60 days after publication in the Federal Register and will apply to a company's 2011 annual meeting if the first anniversary of the mailing of the 2010 proxy materials occurs more than 120 days after effectiveness of the new rules. Implementation of the new proxy access rules for smaller reporting companies (those with a public float less than $75 million) will be deferred for three years.

New Rule 14a-1

> ***Ownership Threshold; Holding Period.*** In a change from the proposed rule, the nominating shareholder must hold voting and investment power equal to at least 3% of the company's voting stock continuously for a three-year period prior to the date that the shareholder notifies the company of its proposed nominees. A group of shareholders may aggregate their shares to reach the 3% threshold. Borrowed shares and shares sold short are excluded from the 3% calculation, but loaned shares that may be recalled (and will be recalled prior to the annual meeting) are included. The shareholder or group of shareholders must continue to own the shares through the annual meeting for which the nominees are submitted, and must not intend to effect a change of control of the company or gain representation on the board beyond that permitted by the rule.

Number and Qualifications of Nominees. The nominating shareholder, including a group of shareholders, may nominate at each election a number of directors equal to the greater of (i) 25% of a company's board of directors or (ii) one director. In the case of a classified board, the 25% calculation would be based on the total number of board seats. If more nominees are submitted than are permitted under the rule, the shareholder with the highest percentage of voting stock who has made a valid nomination will be given preference.

Nominees must satisfy the independence standards of the national securities exchange on which the company's securities are listed. The nomination must not violate applicable state, federal, or foreign law. Neither the nominating shareholder nor the nominee may have a direct or indirect agreement with the company regarding the nomination. There is no restriction on the relationship between the nominating shareholder and the nominee.

Notice Filing. No earlier than 150 days, and no later than 120 days, prior to the anniversary of the mailing date for the prior year's proxy materials, a nominating shareholder must file with the SEC a Notice of Intent on Schedule 14N (the "Notice"), which includes, among other information:

- information regarding the identity of the shareholder or group of shareholders and the nominees similar to that required in a proxy contest, the number and percentage of shares owned; the length of time the shares have been held; and whether each nominee satisfies any director qualifications in the company's governing documents (although the nominee is not required to satisfy such qualifications);
- a certification that the shareholder does not intent to effect a change in control of the company or gain more board seats than are permitted under the rule; and
- a statement of intention to continue to hold the shares through the meeting date.

The Notice may also include a statement supporting the nominee. The nominating shareholder will be liable for any false or misleading information provided to the company. The company will not be liable for information provided by the shareholder and reproduced in the proxy materials.

Nominee Exclusion. A company may seek to exclude a nomination by a shareholder, after providing the shareholder with an opportunity to remedy identified deficiencies, by giving notice to the SEC of the basis for exclusion of the nomination and seeking "no-action" relief, similar to the process for excluding shareholder proposals under Rule 14a-8. Notice to the SEC must be given no later than 80 days prior to the filing of the company's definitive proxy statement.

Amendments to Rule 14a-8

Rule 14a-8 was amended to prevent a company from excluding from its proxy materials shareholder proposals that seek to establish proxy access procedures in the company's governing documents, provided that these proposals do not conflict with or limit Rule 14a-11. The current shareholder eligibility requirements of Rule 14a-8 (requiring that a shareholder has held at least $2,000 in market value or 1% of the company's voting securities, whichever is less, for one year) will continue to apply.

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Related Amendments to Proxy and Ownership Reporting Rules

The SEC also adopted amendments exempting shareholder communications and nominating activities from proxy and ownership reporting rules as follows:

- **Exemption for Shareholder's Intent**. The new rules provide an exemption from the proxy rules for written or oral communications of a shareholder's intent to form a nominating group;
- **Exemption for Supporting Communications**. The new rules provide an exemption from the proxy rules for communications made in support of a nominee included in a company's proxy materials under Rule 14a-11; and
- **Preservation of Schedule 13G Eligibility**. The new rules provide that a nominating shareholder or group of shareholders will not lose eligibility to file the shortened Schedule 13G beneficial ownership report as a result of activities relating to a Rule 14a-11 nomination (although forming a nominating group will trigger a Schedule 13D or 13G filing requirement if the group holds greater than 5%).

Conclusion

Adoption of a mandatory federal right of proxy access marks a new beginning in the area of corporate governance and shareholder rights, and will require an increased focus on investor relations. Public companies should review their applicable governing documents, including advance notice bylaw provisions, to ensure that they operate within the limits of the new shareholder proxy access regime.

—*Kelly C. Simoneaux and Peter J. Rivas*

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT—ADDITIONAL PROVISIONS AFFECTING PUBLIC COMPANIES

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") into law. While the Act is primarily designed to restore responsibility and accountability in the nation's financial system, it also contains a number of provisions affecting companies subject to regulation by the Securities and Exchange Commission (the "SEC"). This E*Bulletin supplements our prior Jones Walker E*Bulletins addressing some of the more significant executive compensation/corporate governance provisions and whistleblower bounty and protection provisions contained in the Act, copies of which may be found here and here, respectively, by briefly summarizing some of the other more notable provisions affecting companies subject to SEC regulation. For a full copy of the Act, click here.

<u>Expanded SEC Enforcement Authority</u>

Aiding and Abetting Liability for Recklessness. The Act makes clear that an individual who acts recklessly can be subject to an enforcement action for aiding and abetting a violation of many of the securities laws. Previously, Section 20(e) of the Exchange Act provided that any person who "*knowingly* provides substantial assistance to another person in violation" of a provision of the Exchange Act or an Exchange Act rule or regulation could be held liable to the same extent as the principal wrongdoer. Some circuit courts interpreting this provision required actual knowledge before aiding and abetting liability could be found; others held that the knowledge requirement was satisfied if the person providing substantial assistance acted recklessly. The Act resolves this circuit split by amending Section 20(e) to provide that any person who "knowingly or recklessly provides substantial assistance" may be subject to an SEC enforcement action. The Act also adds Section 15(b) to the Securities Act, Section 48(b) to the Investment Company Act, and Section 209(f) to the Advisers Act, each of which provide that the SEC can pursue an enforcement action against any person who knowingly or recklessly provides substantial assistance to another person in violation of those acts or any of their rules and regulations.

These revisions apply only to SEC enforcement actions. The Act does not alter the Supreme Court's holding in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), that there is no private right of action for aiding and abetting violations of the securities laws.

Affirmation of the SEC's Authority to Pursue Control Person Liability. The Act amends Section 20(a) of the Exchange Act to make clear that the SEC may pursue enforcement actions against control persons, which is defined as anyone who "directly or indirectly controls any person liable" under the Exchange Act. Previously, Section 20(a) was somewhat ambiguous about whether control persons could only be subject to liability in private actions or whether control persons could also be made a defendant in an SEC enforcement action. That being said, the SEC *has* brought enforcement actions against control persons in the past—although not many—including recent charges against the former CEO of AIG as a control person on the theory that he knew about the effects that certain improper transactions would have on AIG's reported financial results. The Act's affirmation of the SEC's right to bring such an action under the Exchange Act may make such actions more commonplace.

Civil Penalties in SEC Administrative Cease-and-Desist Proceedings. The Act grants the SEC authority to impose monetary penalties against individuals in administrative cease-and-desist proceedings. Previously, the SEC could seek monetary penalties in administration actions *only* against entities and individuals who were registered with the SEC, such as brokerage firms and investment advisors; if it wished to pursue monetary penalties against individuals who were not registered with the SEC, it had to do so in federal district court. Significantly, this revision allows the SEC to pursue monetary penalties against individuals not registered with the SEC without having to try the case before a jury. In addition, factual findings in an administrative proceeding can only be reversed on appeal if a defendant is able to demonstrate the SEC's findings fail to meet the "substantial evidence" test.

The Act allows the SEC to impose penalties in administrative cease-and-desist proceedings of up to $150,000 against a natural person, and up to $725,000 against an entity. These revisions do not affect the SEC’s ability to seek monetary penalties in federal district court under Section 20(d) of the Securities Act and Section 21(d)(3) of the Exchange Act.

Changes to Regulation D

Revised Accredited Investor Standard. The Act directs the SEC to adjust the net worth standard for determining whether an individual qualifies as an “accredited investor” for the purposes of Regulation D of the Securities Act. In order to qualify as an accredited investor, the individual net worth of any natural person, or the joint net worth with the spouse of that person, at the time of purchase must be at least $1,000,000, *excluding* the value of the individual’s primary residence. The prior standard allowed an individual to include the value of his or her primary residence. Pending implementation of the changes to the SEC rules required by the Act, the related amount of indebtedness secured by the primary residence up to its fair market value may also be excluded from the definition of net worth. Indebtedness secured by the residence in excess of the value of the home should be considered a liability and deducted from the investor’s net worth. After a 4-year period, the SEC may further adjust the net worth standard to a higher amount, and at least once every four years the SEC must review the definition of accredited investor in light of the then current economic conditions and public interest.

Disqualification of “Bad Actors” from Regulation D Offerings. The Act requires the SEC to issue rules that would disqualify certain “bad actors” from participating in Regulation D offerings made under Rule 506, including persons who have been convicted of any felony or misdemeanor in connection with the purchase or sale of any security, or persons who have been involved in making false filings with the SEC.

Exemption from SOX 404(b) Made Permanent for Non-Accelerated Filers

Section 404(b) of the Sarbanes-Oxley Act of 2002 (“SOX”) requires a registered public accounting firm that prepares an audit report for a public company to attest to management’s assessment of internal controls and procedures for financial reporting. To date, the SEC has delayed implementation of this requirement for non-accelerated filers and smaller reporting companies. The Act makes this exemption permanent. Section 404(b) and related regulations do, however, continue to require management to report annually on the effectiveness of internal control over financial reporting. The Act requires the SEC to conduct a study to determine how it could reduce the burden of SOX 404(b) on companies with market capitalization between $75 million and $250 million while maintaining investor protections for those companies. The study must also consider whether reducing the compliance burden or providing a complete exemption for these companies would encourage companies to list on U.S. exchanges in their initial public offerings.

Credit Ratings

Rule 436(g) of the Securities Act provides that a security rating assigned to a class of debt securities, convertible debt securities, or preferred stock by a nationally recognized statistical rating organization shall not be considered a part of a registration statement prepared or certified by an “expert” within the meaning of Sections 7 or 11 of the Securities Act.

The Act repeals 436(g), with the effect that the SEC will now consider a company providing a credit rating disclosed in a prospectus or registration statement to be an "expert," and the issuer must include a consent from the rating agency as an exhibit to the registration statement before the registration statement will be declared effective.

Many credit rating agencies have indicated they are not willing to provide their consent due to concerns that they may be subject to potential liability under Section 11 of the Securities Act. In response to the concerns of the credit rating agencies, the SEC issued a six-month moratorium on the requirement to include credit ratings in offerings subject to Regulation AB. In addition, on July 22, 2010, the staff of the SEC Division of Corporation Finance issued a series of interpretations regarding the repeal of Rule 436(g). The interpretations clarify that an issuer may include in a registration statement or prospectus certain "issuer disclosure-related ratings information," such as changes to a credit rating, disclosure of risk factors, discussions relating to the liquidity of the company, the cost of funds for an issuer, and the terms of agreements that refer to credit ratings. Examples of acceptable disclosure items likely include credit rating information in connection with a discussion of liquidity in the MD&A section or disclosure of ratings information in a risk factor with a statement to the effect that a decline in an issuer's credit rating may adversely impact the issuer's borrowing power and ability to raise capital. In addition, the requirement to include a credit rating agency consent does not apply to other documents disclosing a credit rating, such as a free writing prospectus.

The Division of Corporation Finance also clarified that issuers with registration statements declared effective before July 22, 2010, that include ratings information may continue to use their registration statements without filing a consent by the credit rating agency, until the next post-effective amendment, which would include the company's Form 10-K.

In addition to repealing Rule 436(g), the Act also requires the SEC, within 90 days of enactment of the Act, to revise Regulation FD to remove the current exemption for communications to credit rating agencies. Regulation FD places restrictions on selective disclosure of material non-public information, and this exemption clearly allowed issuers to provide credit rating agencies with material non-public information about the issuer without having to publicly disclose such information. In response, several credit rating agencies have issued public statements concerning the impact of the Act on communications with credit ratings agencies under Regulation FD. According to these ratings agencies, the Act's removal of the ratings agency exemption does not mean ratings agencies fall within the scope of the Regulation FD prohibition since ratings agencies are not among Regulation FD's list of enumerated persons to whom selective disclosure is prohibited. While a plain reading of Regulation FD appears to support the agencies' position, the SEC has yet to issue any guidance in response. To ensure compliance, an issuer could enter into a confidentiality agreement with the credit rating agency, as Rule 100(b)(2)(ii) of Regulation FD permits selective disclosure to a person who expressly agrees to maintain the disclosed information in confidence.

<u>Reports Under Section 13 and 16</u>

> ***Section 13 and Section 16 Reporting***. Section 13(d) of the Exchange Act previously required a holder of 5% or more of an issuer's securities to file a statement of beneficial ownership with the SEC, as well as submit a copy to the issuer at its principal executive officer and the exchange where the security is listed, within 10 days of acquisition. The Act permits the SEC to shorten the 10-day period and eliminates the requirement that a Section

13 filer send copies of the Schedule 13D or 13G to the issuer of the security and the exchange where the security is listed. In addition, reporting persons making a filing with the SEC under Section 16 of the Exchange Act no longer need to file such reports with the applicable exchange.

Reporting of Short Sales by Institutional Investment Managers. The Act prohibits “manipulative” short selling and gives the SEC authority to adopt rules necessary to ensure enforcement. The Act also requires the SEC to enact rules providing for at least monthly public disclosure of short sales by institutional investment managers who are currently subject to reporting under Section 13(f) of the Exchange Act.

—*Dionne M. Rousseau*, *Allen E. Frederic, III*, *Britton H. Seal*, and *Avery B. Pardee*

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Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

Curtis R. Hearn
Jones Walker
201 St. Charles Avenue
New Orleans, LA 70170-5100
504.582.8308 *tel*
504.589.8308 *fax*
chearn@joneswalker.com

Corporate & Securities Attorneys

Lynn M. Barrett
Allison C. Bell
Robert B. Bieck, Jr.
William R. Bishop
John C. Blackman, IV
Robert L. Carothers, Jr.
Robert R. Casey
Monique A. Cenac
Scott D. Chenevert
Alexandra L. Clark
Edward B. Crosland
Mollye M. Demosthenidy
Allen E. Frederic, III
Asher J. Friend
Kristin S. Gardner
Carl C. Hanemann
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Sanford B. Kaynor, Jr.
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Jessica F. Natali
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H. Gary Pannell
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Rudolph R. Ramelli
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Myla R. Reizen
Peter J. Rivas
Dionne M. Rousseau
Amy G. Scafidel
Britton H. Seal
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Ronald A. Snider
Hope M. Spencer
R. Troy Van Orman
Michael A. White
Richard P. Wolfe