JONES DAY

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SEC ADOPTS FINAL RULES FACILITATING SHAREHOLDER NOMINATIONS OF DIRECTORS

On August 25, 2010, by a three to two vote, the SEC adopted final rules[1] that, under certain circumstances, require public companies to include shareholder nominees for director in the proxy materials that the company distributes to its shareholders in connection with an annual meeting (or special meeting in lieu of an annual meeting).[2] The new rules also give shareholders the ability to use the shareholder proposal procedure under Rule 14a-8 of the Exchange Act to modify a company's nomination procedures or disclosures about elections through a bylaw amendment, as long as such proposal does not conflict with state law or Rule 14a-11. These proxy access rules, which in various forms have been on the SEC's agenda for years,[3] will become effective 60 days after publication in the Federal Register and, therefore, will immediately affect many companies as they gear up for the 2011 proxy season.

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1 Securities Release Nos. 33-9136; 34-62764, August 25, 2010, "Facilitating Shareholders Director Nominations," *available at* http://sec.gov/rules/final/2010/33-9136.pdf. Chairman Schapiro's opening speech at the adopting meeting is available at http://www.sec.gov/news/speech/2010/spch082510mls.htm. Commissioner Walter's speech supporting the release is available at http://www.sec.gov/news/speech/2010/spch082510ebw.htm. Commissioner Aguilar's speech supporting the release is available at http://www.sec.gov/news/speech/2010/spch082510laa.htm. Commissioner Paredes' speech opposing the release is available at http://www.sec.gov/news/speech/2010/spch082510tap.htm. Commissioner Casey's speech opposing the release is available at http://www.sec.gov/news/speech/2010/spch082510klc.htm. All web sites herein last visited Sept. 7, 2010.

2 The new rules were promulgated under Section 14(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), which, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), permits the SEC to promulgate rules requiring that a company's proxy statement include director nominees submitted by a shareholder or group of shareholders. *See* Section 971 of the Dodd-Frank Act.

3 The SEC's most recent proposal was published in June 2009. For more information related to the 2009 proposals, please see the *Jones Day Commentary* from June 2009, *available at* http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=6342.

DIRECT ACCESS TO PROXY MATERIALS FOR NOMINEES

Under new Rule 14a-11, certain shareholders and shareholder groups may include their nominee(s) for election to the board of directors in the company's proxy materials unless the shareholders are otherwise prohibited—either by state or foreign law or a company's governing documents—from nominating a candidate for election as a director. The rule applies to all Exchange Act reporting companies that have a class of equity securities subject to the proxy rules, although Rule 14a-11 will not become effective for smaller reporting companies (generally companies with less than $75 in public equity float) until November 1, 2013.

Shareholder Eligibility Tests. A shareholder or group is eligible to have its nominee included in the company's proxy materials if the shareholder meets five eligibility tests:

1. **Minimum Ownership.** The shareholder or group must hold at least 3 percent of the total voting power of the company's securities entitled to vote at the meeting. A shareholder or group must hold both investment and voting power, either directly or through any person acting on their behalf. In calculating the ownership percentage held, a shareholder or member of the shareholder group would be able to include securities loaned to a third party if they can be recalled and will in fact be recalled if the nominee is included. In determining the total voting power held by the shareholder or any member of the shareholder group, securities sold short (as well as securities borrowed that cannot or will not be recalled) cannot be included for purposes of satisfying the ownership test.
2. **Minimum Holding Period.** The shareholder or group must have held the qualifying percentage of shares for at least three years prior to the date notice is given to the company of the intent to submit nominees for inclusion in the proxy materials and must continue to hold that amount through the date of the election.[4]
3. **Declaration of Intent.** The shareholder must make a statement on new Schedule 14N (a) declaring its intent to continue to hold its shares through the date of the annual meeting at which directors are to be elected and (b) concerning its intent with regard to continued ownership after the election.
4. **No Change in Control Intention or Effect.** A shareholder may not hold any of the company's stock for the purpose, or with the effect, of changing control of the company or to gain more than a limited number (generally 25 percent, as discussed below) of seats on the board of directors.
5. **Absence of Agreement.** The shareholder must not have a direct or indirect agreement with the company regarding the nomination of its nominee(s) to serve on the company's board of directors prior to the filing of the Schedule 14N.

Shareholder Nominee Requirements. Each shareholder nominee must satisfy two requirements to be included in the company's proxy materials:

1. **No Violation of Law.** The nominee's candidacy or, if elected, board membership must not violate applicable state, federal, or foreign law or the rules of the applicable national securities exchange or national securities association, and such violation is not able to be cured during the provided time period.
2. **Independence.** The nominee must satisfy the objective independence criteria of the applicable national securities exchange or national securities association that apply to directors generally.[5] More specific independence standards applicable to audit committees, compensation committees, or listings standards that require the application of any subjective criteria would not have to be satisfied.

Limit on Number of Board Nominees. Shareholders, in the aggregate, may not nominate more than the greater of (a) one nominee or (b) a number of nominees that represents up to 25 percent of the total aggregate number of seats on a company's board of directors. If 25 percent does not result in a whole number, the maximum number of shareholder nominees for director will be rounded down to the closest whole number less than 25 percent. For example, if an

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4 The three-year holding requirement would apply only to the securities of the shareholder or each member of the shareholder group that are used for purposes of determining the ownership threshold.

5 With respect to registrants that are investment companies, the nominee may not be an "interested person" as defined in section 2(a)(19) of the Investment Company Act of 1940.

annually elected board comprises 12 members, three shareholder nominees could be included in the proxy materials. If a company has a classified board, the 25 percent calculation would still be based on the total number of board seats, and not the number of seats up for election in any given year. If a company has a director currently serving on the board who was elected as a shareholder nominee pursuant to Rule 14a-11, and that director's term extends past the date of the election, he or she will count toward the 25 percent limitation.

If a company agrees to include a shareholder nominee in its proxy statement as an unopposed nominee, and if the shareholder nominee was submitted to the company by the nominating shareholder or nominating shareholder group pursuant to a notice on Schedule 14N prior to reaching such agreement with the company, that individual will be considered a shareholder nominee for purposes of calculating the maximum number of shareholder nominees that must be included in the company's proxy statement. Any other unopposed nominee included pursuant to an agreement with the company will not count toward the maximum number of shareholder nominees.

Rather than the proposed first-come first-served standard, if a company receives more shareholder nominees than it is required to include in its proxy materials, the company would be required to include in its proxy materials the nominee or nominees of the nominating shareholder with the highest qualifying voting power percentage at the time the nominating shareholders file the Schedule 14N. Where the nominating shareholder or group with the highest qualifying voting power percentage does not nominate the maximum number of individuals required to be included, the nominees of the shareholder or group with the next highest qualifying voting power percentage would be included up to and including the total number required to be included. This process would continue until the company has included the maximum number of nominees it is required to include or the company exhausts the list of eligible nominees.

New Schedule 14N—Shareholder and Nominee Disclosures. A nominating shareholder or group must file with the SEC and submit to the company a Schedule 14N. Schedule 14N is a form that requires disclosure of (a) facts supporting the shareholder's eligibility to nominate a director and (b) information related to the nominating shareholder or group.

The information required to be disclosed in the Schedule 14N includes, among other things, the following:

- Disclosure concerning:

  a. The amount and percentage of voting power of the company's securities entitled to be voted by the nominating shareholder or group and the length of ownership of those securities;
  b. Biographical and other information about the nominating shareholder or group and the shareholder nominee, similar to the disclosure currently required in a contested election; and
  c. Whether or not the nominee satisfies the company's director qualifications, if any, as provided in the company's governing documents.

- Certifications that, after reasonable inquiry and based on the nominating shareholder's or group's knowledge, the:

  a. Nominating shareholder (or, where there is a nominating shareholder group, each member of the nominating shareholder group) is not holding any of the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11;
  b. Nominating shareholder or group otherwise satisfies the requirements of Rule 14a-11, as applicable; and
  c. Nominee or nominees satisfy the requirements of Rule 14a-11, as applicable.

- A statement that the nominating shareholder or group members will continue to hold the qualifying amount of securities through the date of the meeting and a statement with regard to the nominating shareholder's or group member's intended ownership of the securities following the election of directors (which may be contingent on the results of the election of directors).

- At the option of the nominating shareholder or group, a statement in support of each shareholder nominee, not to exceed 500 words per nominee.

The nominating shareholder or group will be liable for any false or misleading statements in the information contained in the Schedule 14N, including when that information is subsequently included in the company's proxy materials. As such, the company will not be responsible for information provided by the shareholder or group.

Timing of Nominations. Under the new rules, nominations must be submitted to the company, and the Schedule 14N must be filed with the SEC, no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement and no later than 120 days prior to such date. The final rule differs from the proposed rule, which would have required the nominating shareholder or group to provide notice to the company no later than 120 days prior to the anniversary of the mailing of the prior year's proxy statement or in accordance with the company's advance notice bylaw, if applicable. The nominating shareholder or group will be required to file on EDGAR and transmit to the company its notice on Schedule 14N on the same date.

Exclusion of Nominees. Rule 14a-11 imposes affirmative notice requirements on companies that receive notice of a shareholder nomination on Schedule 14N. First, if a company determines that it will include a Rule 14a-11 nominee in its proxy materials, it must provide the nominating shareholder or group with notice of such fact not later than 30 calendar days before the company files its definitive proxy statement with the SEC. Second, if a company determines that it is not required to include a nominee in its proxy materials, the company and the proponent must follow the procedure for exclusion included in Rule 14a-11(g)[6], set forth below:

DUE DATE	ACTION REQUIRED
Promptly after the company's receipt of the nominating shareholder's or group's notice on Schedule 14N.	Company must make an affirmative determination whether it is permitted to exclude a nominee.
No later than 14 calendar days after the close of the nomination period.	Company must notify the nominating shareholder or group of any determination to exclude the nominee or nominees or a statement of support.
Within 14 calendar days after the nominating shareholder's or group's receipt of the company's deficiency notice.	Nominating shareholder must respond to the company's deficiency notice and, if possible, cure defects.
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the SEC.	Company must provide notice to the SEC of its intent to exclude the nominating shareholder's or group's nominee or nominees, or a statement of support, and the basis for its determination to the SEC and, if desired, seek a no-action letter from the staff with regard to such determination.
Within 14 calendar days of the nominating shareholder's or group's receipt of the company's notice to the SEC.	Nominating shareholder or group may submit a response to the company's notice to the SEC.
As soon as practicable following receipt of nominating shareholder's or group's response.	SEC would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group.
Promptly following receipt of the staff's informal statement of its views.	Company must provide notice to the nominating shareholder or group stating whether it will include or exclude the nominee.

If the deficiency relates to the composition of either the nominating shareholder group or the nominee identified in the notice, the nominating shareholder or group may not cure the deficiency or amend the notice. If the nominating shareholder or group inadvertently nominated a number of nominees that exceeds the maximum number required to be included, the shareholder may specify which nominee(s) are to be included.

6 All materials submitted to the SEC pursuant to Rule 14a-11(g) would be publicly available upon submission.

EXEMPTIONS FOR SOLICITATIONS BY NOMINATING SHAREHOLDERS

To facilitate solicitations by nominating shareholders, the new rules exempt from regulation under the proxy rules solicitations by shareholders to form nominating shareholder groups or to support the election of shareholder nominees. The rules also clarify that a shareholder who is Schedule 13G-eligible would not lose such eligibility solely as a result of making a nomination, soliciting in favor of a nominee, or having a nominee elected to the board under the proposed rules.

SHAREHOLDER PROPOSALS UNDER AMENDED RULE 14-8(i)(8)

Currently, Exchange Act Rule 14a-8(i)(8) permits companies to exclude shareholder proposals that "relate to an election." Under amended Rule 14a-8(i)(8), shareholder proposals by eligible shareholders that would amend, or request an amendment to, provisions of a company's governing documents concerning the company's nomination procedures or other director nomination disclosure provisions, which are consistent with Rule 14a-11 and state law, cannot be excluded.

The current eligibility provisions of Rule 14a-8 continue to apply. Those provisions require that a shareholder proponent have continuously held at least $2,000 in market value (or 1 percent, whichever is less) of the company's securities entitled to be voted on the proposal at the meeting for a period of one year prior to submitting the proposal.

EFFECTIVE DATES AND 2011 TRANSITION ISSUES

The new rules will become effective 60 days after publication in the Federal Register and, therefore, will immediately affect those companies with notice deadlines that fall after the date of the new rules' effectiveness (*e.g.*, if the new rules are published in the Federal Register on September 10, 2010, they would become effective on November 9, 2010 and would affect companies that mailed their proxy materials for the 2010 annual meeting on or after March 9, 2010). Shareholders would not be permitted to submit nominees pursuant to Rule 14a-11 for inclusion in the company's proxy materials for the 2011 season if the 120-day notice period expired before the new rules became effective.

STATE LAW DEVELOPMENTS

On April 10, 2009, Delaware passed new legislation permitting, but not requiring, Delaware companies to adopt bylaws that would provide for shareholder access to company proxy materials for the purpose of proposing director nominees pursuant to the procedures and conditions set forth in such bylaws, and for the reimbursement of expenses incurred by the nominating shareholder in soliciting proxies.[7] Such bylaws can be adopted either by the company's board of directors or by the shareholders. Bylaws adopted under new Section 112 of the Delaware General Corporation Law (the "DGCL"), which became effective August 1, 2009, may include procedures and conditions under which a company soliciting proxies for the election of director nominees would also be required to include in its proxy materials nominees submitted by shareholders.

POTENTIAL IMPLICATIONS AND ACTION ITEMS

The SEC proxy access rules and the changes to Delaware law described above are parts of a larger ongoing debate on corporate governance issues. Political changes, coupled with the passage of federal legislation regulating executive pay practices for recipients of Troubled Asset Relief Program ("TARP") funds and the Dodd-Frank Act, have raised new concerns over the ability of directors to oversee executive compensation practices and risk management. In a move toward giving shareholders a greater voice in this oversight process, the new rules potentially increase the frequency of proxy contests, pitting management nominees against shareholder representatives in board elections.

Companies and their boards of directors must now work within the "one-size-fits-all" requirements of the new proxy access rules. Accordingly, public companies should consider

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7 Del Code Tit. 8 §112.

the potential implications of the new rules and other action items described below:

Director Nomination Procedures and Qualifications. Most public companies have established procedures for the nomination of directors and the qualifications for those nominees. These procedures and qualifications are set out in a company's bylaws, corporate governance guidelines (and related director qualification criteria), and certain committee charters, all of which should be reviewed in light of the new rules. In particular:

- Advance notice bylaws should be reviewed to confirm that they are not inconsistent with proposals or nominations made pursuant to Rules 14a-8 and 14a-11, and are otherwise designed to provide adequate notice (with respect to both timing and content) with respect to director nominations. In particular, where Rule 14a-8 and Rule 14a-11 would require notice earlier than the applicable advance notice bylaw, companies should consider conforming their advance notice bylaws to the SEC timeline. In addition, consideration should be given to including express statements to the effect that the advance notice bylaws do not apply to proposals and nominations made pursuant to, and in accordance with, Rule 14a-8 and Rule 14a-11, respectively.
- The proxy statement disclosure required by Schedule 14A relating to the timing for shareholders or groups seeking to propose director nominees to the company's nominating or corporate governance committee will need to be revised to reflect the new requirements applicable to a shareholder or group utilizing Rule 14a-11 to have a nominee included directly on the proxy ballot.
- Criteria for director selection contained in a company's corporate governance guidelines, board committee charters, and bylaws, as well as the company's related proxy disclosure, should be reviewed to clarify that they relate to the selection by the company's governance committee of nominees and, as such, would not necessarily apply to a Rule 14a-11 shareholder nominee. Rule 14a-11 requires proposing shareholders to disclose whether, to their knowledge, their nominees meet the company's director qualifications set forth in its governing documents (although failure to satisfy such qualification requirements would not preclude the nomination or election of a nominee).
- Governance documents and recent board actions relating to the size of the board should be reviewed to confirm that the company has no vacancies on the board that could be filled through a shareholder nomination.

Vote Standard for Election of Directors. If a company has a non-plurality voting standard that applies to the election of directors—such as a majority vote standard—it should be reviewed to determine what effect the inclusion of a Rule 14a-11 nominee in the company's proxy materials would have on the shareholder vote. In particular, the definition of a "contested election" may have different meanings in different contexts. As a result, a company should analyze the circumstances under which the election becomes contested and a plurality vote standard would apply. If the plurality vote standard would not be triggered by a Rule 14a-11 nomination, companies should consider modifying their majority vote standard to clarify that where the number of nominees exceeds director vacancies, a plurality vote standard will apply. Because NYSE Rule 452 forbids brokers from voting shares held in street name for director candidates, this change will help minimize potential "failed" elections under a majority vote standard.

Concerns Related to Shareholder Nominees. Boards, led by their corporate governance committees, will need to assess the expected likelihood of a shareholder director nominee. Companies with activist shareholders will be particularly vulnerable to shareholder nominees. Corporate governance committees should assess whether the effect of the rule could facilitate the election of "special interest" (*e.g.*, public pension fund or union representatives) directors to their board, or hinder the election of certain company-supported directors with specific skill sets. In particular:

- Companies should review their shareholder list to identify which shareholders or groups of shareholders would have the requisite share ownership (as of the measurement date set forth in the rule) that would enable them to present nominations for inclusion in the proxy materials.
- An analysis of the company's shareholder profile should include a review of the type of shareholder, size of holdings, turnover pattern, and length of holdings.
- The company should assess whether its shareholders are "activist" shareholders, whether and which shareholders may be inclined to act as a group (and if so, with whom),

what positions shareholders have articulated, and what the company's relationship with such shareholders has been over time.

- Depending on the results of this assessment, boards may decide to open a dialogue with shareholders who are likely to propose nominations for inclusion on the proxy so as to avoid an impairment of the board's ability to function effectively.
- In addition, companies should revisit how the board's performance has been rated and corporate governance assessments, as poorly rated boards may be more likely to face shareholder nominations.

State Law Interplay. Companies incorporated outside of Delaware should analyze the corporation law in their jurisdictions of incorporation governing shareholders' ability to include director nominations in the company's proxy materials to assess whether there is a conflict between state law and the new SEC rules. Companies should also monitor any state law changes that may affect proxy access procedures. Enabling statutes are intended to grant companies and shareholders flexibility under state law to adopt a proxy access bylaw tailored specifically to each company's and its shareholders' needs, including a shareholder proposed bylaw contemplated by the amendments to Rule 14a-8. However, a company may not effectively opt out of Rule 14a-11 by adopting alternative or more restrictive bylaw requirements for inclusion of a shareholder nominee in the proxy materials.

Effect on the Corporate Governance Committee Processes. If properly employed by a shareholder, Rule 14a-11 allows shareholders to bypass the board's corporate governance committee, and the board itself, to include shareholder nominees in the proxy materials. As a result, the corporate governance committee and the board may have only a limited opportunity to consider whether the nominees are suitable to serve under the company's pre-established and specific categorical independence criteria. The board will also have only a limited opportunity to determine whether a nominee fills any needs of the board in regard to prior business experience, financial expertise (required for Audit Committee membership), special technical expertise, categorical independence, diversity, or other factors that ensure the effectiveness of a board and its committees, although a nominee shareholder's Schedule 14N disclosure must address such qualifications. Accordingly, the corporate governance committee should be prepared to review any Rule 14a-11 nominee to determine whether such nominee meets the director eligibility standards of the rule and objective independence tests of the securities exchanges. Although not a bar to a Rule 14a-11 nomination, counsel should also assess and review with the corporate governance committee whether any shareholder nominee would qualify (a) under the company's specific governance criteria for board nominees, (b) for audit and compensation committee membership, and (c) as "independent" under the company's specific categorical independence standards. The applicable committee charter(s) should be revised to reflect the possible need for these committee processes.

Determining Eligibility of Rule 14a-11 Proponents and Nominees. If a company receives a Rule 14a-11 nomination, it will need to obtain documentary support to confirm a shareholder's eligibility to propose a nominee and whether the nomination complies with applicable rules and laws. Each shareholder nominee must also be reviewed under the rule's criteria to determine eligibility to serve on the board. Companies should make sure appropriate procedures are in place to promptly review and respond to Rule 14a-11 nominations within the specified timeline described above. Companies should assess whether sufficient internal controls are in place to monitor any nomination notices they receive in order to promptly determine whether a shareholder proponent or Rule 14a-11 nominee may be excluded under Rule 14a-11(g).

Monitoring Investment Intention of Shareholder Proponents. To be eligible to submit a nominee for inclusion on the company's proxy ballot, a shareholder must certify it is not holding the company's stock with the intention of changing control of the company. Accordingly, the company should continue to review and analyze the conduct and share ownership of any proponent shareholder (including Schedule 13D and 13G filings) to determine whether the certification remains accurate.

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