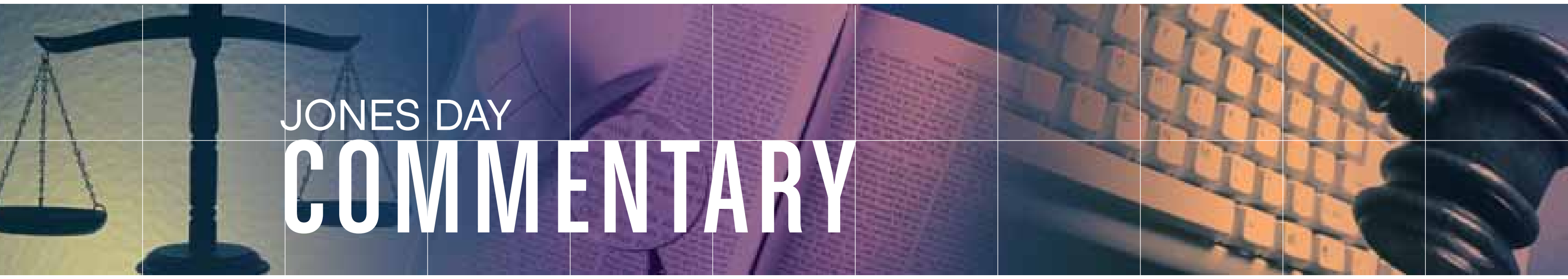
JULY 2011



D.C. CIRCUIT COURT OF APPEALS VACATES PROXY ACCESS RULE

On July 22, 2011, the United States Court of Appeals for the D.C. Circuit vacated Rule 14a-11, the proxy access rule adopted by the Securities and Exchange Commission in August 2010. The rule would have required companies to include in their annual meeting proxy materials director candidates nominated by shareholders meeting certain ownership and other requirements. The Business Roundtable and the U.S. Chamber of Commerce filed a legal challenge to the rule in September 2010, arguing that the SEC acted arbitrarily and capriciously in adopting the proxy access rule by neglecting its statutory responsibility to determine the rule's likely economic effects. The court agreed, adding scathing criticism of the SEC's effort, stating that the SEC inconsistently and opportunistically framed the costs and benefits of the rule and failed to respond adequately to substantial problems raised by commenters to the rule.

The court highlighted several deficiencies in the SEC's analysis and adoption of Rule 14a-11. First, the court noted that, in spite of "readily available" empirical evidence about the costs of traditional proxy contests, the SEC failed to quantify the costs that a company would be expected to incur if its board of directors determined to oppose a shareholder nominee. Second, the court determined that the SEC's reliance on two "relatively unpersuasive studies" in support of its conclusion that Rule 14a-11 would improve board performance and increase shareholder value was unjustified, particularly in light of numerous studies submitted by commenters that reached the opposite result. Third, the court held that the SEC acted arbitrarily by failing to consider how unions, public pension funds, and other special interest groups could use the rule to promote their narrow interests at the expense of other shareholders. Finally, the court noted the inherent conflict in the SEC's analysis that assumed frequent use of Rule 14a-11 when estimating the rule's benefits to shareholders, but assumed the opposite when estimating its costs to companies.

© 2011 Jones Day. All rights reserved. Printed in the U.S.A.

The D.C. Circuit's decision to vacate proxy access is a decisive victory for public companies and their shareholders. Further, it is a reasoned and welcome relief from the outlook seemingly designed to foster reckless short-termism and so-called shareholder democracy that culminated with the adoption of Dodd-Frank a year ago. Rule 14a-11 would have presented a clear opportunity for single issue activists, like unions, to reconfigure public company boards with aims other than shareholder value. In addition, the rule surely would have intensified the already powerful pressure for companies to focus on quarterly results rather than long-term shareholder value.

The battle for proxy access is likely not over. Because the court's decision was based solely on administrative grounds—the court did not address the Business Roundtable and U.S. Chamber of Commerce's challenge to the rule under the First Amendment—the SEC could craft a revised rule and undertake a more vigorous economic analysis to support it. It is unclear whether the SEC will immediately pursue another proxy access rulemaking initiative in light of its already heavy workload and the fact that many of the other Dodd-Frank rulemaking projects are considerably behind schedule. While it is safe to assume that proxy access will not be a factor for the 2012 proxy season, the 2010 amendments to Rule 14a-8, which bar companies from excluding shareholder proposals that seek to establish procedures for nominations of directors by shareholders, were not challenged. The SEC will likely lift the stay on these amendments, but it has not made clear whether it will lift the stay before the 2012 proxy season or whether it expects to modify those rules before the stay is lifted. We should also expect that unions, pension funds, and other shareholder activist groups will continue their long-standing campaign for proxy access, and they may also intensify their efforts to promote majority voting standards for the election of directors of public companies as a substitute for proxy access.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Mark E. Betzen
Dallas
+1.214.969.3704
mbetzen@jonesday.com

Robert T. Clarkson
Silicon Valley
+1.650.739.3996
rtclarkson@jonesday.com

Lyle G. Ganske
Cleveland
+1.216.586.7264
lganske@jonesday.com

Christopher M. Kelly
New York
+1.212.326.3438
ckelly@jonesday.com

Jennifer C. Lewis
Cleveland
+1.216.586.1072
jclewis@jonesday.com

Timothy J. Melton
Chicago
+1.312.269.4154
tmelton@jonesday.com

Robert A. Profusek
New York
+1.212.326.3800
raprofusek@jonesday.com

Lizanne Thomas
Atlanta
+1.404.581.8411
lthomas@jonesday.com

Jones Day publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information purposes only and may not be quoted or referred to in any other publication or proceeding without the prior written consent of the Firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our "Contact Us" form, which can be found on our web site at www.jonesday.com. The mailing of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the Firm.