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Back to the Drawing Board – D.C. Circuit Court of Appeals Strikes SEC’s Proxy Access Rule

Last Friday, the U.S. Court of Appeals for the District of Columbia vacated the Securities and Exchange Commission’s (SEC or Commission) proxy access rule (Rule 14a-11 of the Securities Exchange Act) after concluding that the Commission “acted arbitrarily and capriciously for having failed once again . . . adequately to assess the economic effects of a new rule.” The opinion criticizes the SEC for inconsistent and opportunistic analysis of the costs and benefits of the rule, failing to adequately quantify certain costs or explain why they could not be quantified, failing to support its own predictive judgment, contradicting its own statements, and failing to address substantial problems raised in the comments to the proposed rule.

As outlined in our September 21, 2010 client alert, the proxy access rule – which was already under development at the SEC before being expressly authorized by the Dodd-Frank Act – required that public companies (including registered investment companies) allow certain shareholders to include director nominees in the companies’ proxy materials. On October 4, 2010, the SEC stayed the effective date of the rule, as well as related “private ordering” amendments, pending resolution of a petition for review filed by the Business Roundtable and the U.S. Chamber of Commerce that challenged the rules for failing to assess the impact on “efficiency, competition, and capital formation” as required by applicable law.

The D.C. Court of Appeals agreed with the petitioners that the SEC neglected to quantify the costs associated with the rule, including the possibility that special interest groups such as union and state pension funds might attempt to use the rule to extract concessions that were unrelated to shareholder value. Rather, the court found that the SEC acted arbitrarily by “ducking serious

evaluation of the costs that could be imposed upon companies from the use of the rule by shareholders representing special interests.”

The court was also troubled by the SEC’s failure to respond to significant issues and conflicting evidence raised in the comments. The decision highlighted several examples in which the SEC ignored studies and evidence that contradicted its decisions. This, the court found, led the SEC to speculative, unpersuasive, illogical and, in the end, unacceptable conclusions.

The decision was especially critical of the SEC’s application of the proxy access rule to investment companies. The court chided the SEC for its lack of attention to concerns raised by the Investment Company Institute and the Independent Directors Council, among others, that the regulatory requirements already imposed by the Investment Company Act of 1940 reduced the need for, and the benefits to be derived from, proxy access for shareholders of investment companies. Furthermore, the rule would impose greater costs on investment companies by upsetting the “unitary and cluster board structures with the introduction of shareholder-nominated directors who sit on the board of a single fund, thereby requiring multiple, separate board meetings and making governance less efficient.”

Aside from acknowledging its disappointment with the ruling and noting that the decision did not impact its rule that allows shareholders to submit proposals for proxy access, the SEC has not indicated if it will pursue further rules to mandate shareholder access to company proxy materials for director elections. If it does, the Commission will need to rectify multiple deficiencies in its initial rulemaking as identified by the court. Regardless, it is clear that proxy access will not apply to the 2012 proxy year.

What This Means to You

Public companies will enjoy a reprieve from the proxy access rules for now. While the SEC may request a rehearing *en banc* at the D.C. Circuit, appeal the decision to the Supreme Court or choose to revisit the matter in a new rulemaking proceeding, it appears that mandatory proxy access for shareholder director nominees will not be an issue in 2012. However, since the SEC may lift the stay on its amendments to Rule 14a-8, which were designed to facilitate “private ordering” arrangements for proxy access through the shareholder proposal process and were not affected by the decision, companies may see several shareholder proposals on this subject during the 2012 proxy season

Contact Info

If you have any questions about these rules or any other SEC compliance matters, please contact your Husch Blackwell attorney.

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