



Proxy Access Rule Vacated by D.C. Circuit

July 29, 2011

On July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit vacated Rule 14a-11, the proxy access rule adopted by the SEC last summer to grant shareholders the right to include director nominees in company proxy materials. The D.C. Circuit held that the SEC, in adopting Rule 14a-11, exercised its statutory authority in an “arbitrary and capricious” manner by failing adequately to evaluate the economic effects of the new rule, as required under the Administrative Procedure Act.

In the opinion, which did not address the First Amendment challenge raised by the Business Roundtable and the Chamber of Commerce, the D.C. Circuit criticizes the SEC, among other things, for “inconsistently and opportunistically” framing the costs and benefits relating to the application of the rule, failing to satisfactorily quantify or explain how certain costs would be minimized or benefits maximized, neglecting to support its “predictive judgments” and failing to respond to considerable issues raised by commenters. The litany of faults in the cost/benefit analyses that the D.C. Circuit highlights includes the failure of the SEC to sufficiently address the potential costs to companies of special interest shareholders who seek access to promote their narrow goals at the expense of maximizing shareholder value for other shareholders (such as union and pension funds requesting benefits for unionized workers), which is an issue that consistently has been raised by commentators throughout the proxy access debate.

After vacating the rule generally, the Court forewarns the SEC of its even more serious objections to the application of Rule 14a-11 to investment companies, pointing again to the failure of the SEC to address fundamental economic issues raised by adoption of the rule. In this context, the Court observes the fact that investment companies are already subject to the purview of the Investment Company Act of 1940, which in certain cases partly deals with concepts that Rule 14a-11 was meant to address.

Rule 14a-11 was adopted after a vigorous debate by a 3-to-2 vote along party lines, so what this decision means for the future of proxy access at this point is unclear. The SEC is considering its options. The possibility still exists that the SEC may decide to address the defects noted by the D.C. Circuit and seek to promulgate a revised Rule 14a-11 proxy access regime in the future. The SEC may choose instead to seek a rehearing by the full nine-judge D.C. Circuit or it could seek review by the Supreme Court. In any event, it seems highly unlikely that Rule 14a-11 will be applicable to the 2012 proxy season.

Whether or not the SEC decides to pursue Rule 14a-11 again, the SEC still has the option to lift its voluntary stay on the amendments to Rule 14a-8, which were not addressed by the D.C.

Circuit opinion, thereby allowing shareholders to propose and adopt bylaws amendments to establish proxy access rules on a company-by-company basis.

Read the full decision [here](#).

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