Securities Alert: D.C. Circuit Court Vacates Proxy Access Rule

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CLIENT ALERT | 7.27.2011

On July 22, 2011, the United States Court of Appeals for the District of Columbia Circuit (the "Court") vacated the U.S. Securities and Exchange Commission's (the "Commission") Rule 14a-11. This controversial rule was adopted shortly after the Dodd-Frank Act clarified the Commission's authority to promulgate the rule. As a result of the Court's decision, Rule 14a-11 will not go into effect.

Rule 14a-11 would have permitted any shareholder or group of shareholders holding at least three percent of the voting power of a public company's securities for at least three years to include director nominees in the company's proxy materials. The rule applied to all public companies and registered investment companies subject to the proxy rules.

Rule 14a-11 was adopted on August 25, 2010 and challenged by the Business Roundtable and U.S. Chamber of Commerce in a lawsuit filed on September 29, 2010. As a result of the suit, the Commission voluntarily stayed the effectiveness of both Rule 14a-11 and the related amendment to Rule 14a-8, which would allow shareholders to propose changes to a company's own proxy access provisions or other election or nomination procedures.

The Court stated in its opinion that:

the Commission acted arbitrarily and capriciously for having failed . . . adequately to assess the economic effects of a new rule. Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.

Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission (D.C. Cir. July 22, 2011)

The Court further stated that the Commission "relied upon insufficient empirical data when it concluded that Rule 14a-11 will improve board performance and increase shareholder value."

The Commission must now decide if it will pursue further court action on Rule 14a-11 or seek to address the concerns raised by the Court with respect to Rule 14a-11. If the Commission elects to propose a modified proxy access rule, it will need to overcome the deficiencies identified by the Court. The Court did not comment on the Rule 14a-8 changes in its opinion.

In a statement released after the Court's decision, the Commission staff stated that it is "considering [its] options going forward," and noted that its rule "allowing shareholders to submit proposals for proxy access at their companies [Rule 14a-8] . . . is unaffected by the court's decision." Accordingly, the Commission may decide to lift the stay of the Rule 14a-8 provision which would permit "private ordering" of proxy access at public companies by enabling eligible shareholders to submit proposals for inclusion in a company's proxy materials that seek to create a proxy access process at that company. If the Commission lifts its stay of the amendments to Rule 14a-8, public companies will need to prepare to address these types of shareholder proposals in the coming proxy season.
