

U.S. Court of Appeals Vacates SEC Proxy Access Rule

Highlights

- In response to the court's vacating of proposed "proxy access" Rule 14a-11, the SEC announced that it is considering its options going forward and noted that amendments to Rule 14a-8, which allow shareholders to submit proposals for proxy access rules at their companies (i.e., private ordering), are unaffected by the court's decision
- Litigation options for the SEC include seeking a hearing before the full appeals court or filing a petition for certiorari at the Supreme Court
- The SEC may re-propose proxy access rules, though several observers believe that it will be difficult to overcome the cost/benefit hurdles; alternatively, given that the original proxy access rules were adopted by a narrow 3-2 vote along party lines, the SEC may simply abandon the 14a-11 initiative altogether
- In light of the lengthy regulatory and administrative process, and the potential for additional litigation, it is unlikely that proxy access will be in place for the 2012 proxy season (though the SEC may choose to lift the stay on the 14a-8 amendments that were not subject to the court's decision)
- Insurgent shareholders continue to have other options, such as traditional proxy contests without access to the company proxy statement and bylaw access to the company proxy statement under recent amendments to Delaware law
- Proxy access will continue to be a heated issue, with many proponents among state and union pension funds, shareholder rights and governance advocates, academics and members of Congress

On July 22, the United States Court of Appeals for the District of Columbia Circuit in [*BUSINESS ROUNDTABLE AND CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA v. SECURITIES AND EXCHANGE COMMISSION*](#) vacated the SEC's new "proxy access" rule, Rule 14a-11, that would have afforded qualified shareholders access to company proxy materials to nominate and solicit votes for their own candidates for election as directors. The decision was grounded on the Court's determination that the Securities and Exchange Commission acted arbitrarily and capriciously, in violation of the Administrative Procedure Act, by failing to adequately consider the effect of the rule upon efficiency, competition and capital formation, as required by the Securities Exchange Act of 1934 and the Investment Company Act of 1940.

Effect on Public Companies

The practical effect of the Court's decision is that in the 2012 proxy season, it is unlikely that shareholders will be able to propose nominees for company boards and have them included in company proxy statements and proxy cards alongside the nominees proposed by the incumbent board.

For most public companies in the United States, the ease with which insurgents can seek and obtain election to boards has increased in recent years, even without the benefit of amended Rule 14a-11. For many issuers, a substantial proportion of voting shares is held by institutions, greatly reducing the effort that

needs to be made to reach shareholders who can in the aggregate cast a decisive vote.

Furthermore, many institutions follow the recommendations of proxy advisory firms, reducing the effort necessary to reach and win the vote of substantial shareholders. The ability to communicate and solicit proxies by means of the Internet has also considerably reduced the expense of reaching out to and communicating with shareholders. The total effect of these developments in proxy solicitations means that companies cannot rest easy, even without shareholder access under Rule 14a-11.

Investment Company Considerations

The proxy access rule was of noted concern to registered investment companies (funds) because of its potential to disrupt the unique governance structure prevalent in the fund industry, where unitary or cluster boards effectively oversee multiple funds. Moreover, as the Court found, the SEC failed to adequately consider whether the rule would provide sufficient benefits to

funds in light of the regulatory protections already provided fund shareholders by the Investment Company Act of 1940. The Court took pains to warn the SEC that, should it decide to readopt a proxy access rule after having more fully considered the justifications and effects, the agency must seriously consider the valid concerns of funds before subjecting them to any readopted proxy access rule. In specifically noting the failure to adequately consider the impact of the rule on funds, the Court accepted the positions argued by Dechert in an [amicus brief](#) we submitted on behalf of the Investment Company Institute and Independent Directors Council.

Because the Court's decision is based on its view of shortcomings in the administrative procedures mandated by statute, it leaves open the possibility that the SEC will conduct a more robust examination of the effects of shareholder action and once again adopt the rules vacated by the Court. As noted above, however, it would be virtually impossible for this to be completed in time for shareholder access to be in place for the 2012 proxy season.

Practice group contacts

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