DC Circuit Court of Appeals Vacates Controversial SEC Proxy Access Rule

On July 22, 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated Rule 14a-11 of the Securities Exchange Act of 1934, which would have required a company to include director nominees of qualifying stockholders in its proxy solicitation materials. Calling the SEC's enactment of the rule "arbitrar[y] and capricious ...",[1] this ruling comes as a blow to the SEC's recent rulemaking efforts. The proxy access rules were the result of a prolonged, high-profile initiative of the SEC that was opposed by many business interests and were considered a significant victory for stockholder-rights activists.

Rule 14a-11 was to become effective November 15, 2010, but had been stayed pending the outcome of this challenge by the Business Roundtable and U.S. Chamber of Commerce. The rule would have required a public company to include in its proxy statement for its annual meeting the director nominees of any stockholder (or group of stockholders) who held at least 3% of the voting power of that company's securities for at least three years. Without Rule 14a-11, stockholders seeking to elect their director nominees have to prepare and circulate their own proxy statements, bearing the full cost of the solicitation.

In vacating Rule 14a-11, the Court found that the SEC had failed to assess the economic effects of the rule, and because the rule is arbitrary and capricious on its face, it is inapplicable and invalid for all issuers. The Court particularly criticized the SEC's analysis of the costs and benefits associated with the utilization of the proxy access rules, noting that the SEC had discounted the rule's costs but not its benefits.

In particular, the Court found that the SEC improperly dismissed the likelihood that company directors might choose to oppose stockholder nominees and therefore failed to estimate the costs of proxy contests. The Court stated that the SEC relied on "insufficient empirical data" about the effect proxy access would have on improving board performance and increasing stockholder value by facilitating the election of dissident stockholder nominees. Finally, the Court noted that the SEC failed to consider the possible improper use of Rule 14a-11 by activist stockholders, such as unions and pension funds, to negotiate unrelated issues with a company.

It is not clear what the SEC will do next. It could seek *en banc* review by the DC Circuit or seek review by the Supreme Court. Or, it could adopt the same or other proxy access rules on a new record. However, the decision does raise the bar on administrative rulemaking and, absent a quick en banc reversal, proxy access rules are unlikely to be in effect before the 2013 proxy season.

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[1] *Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission*, No. 10-1305 (D.C. Cir. July 22, 2011) (the "*Slip Opinion*") at 7.

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