

## **D.C. Circuit Vacates Proxy Access Rule**

The Securities and Exchange Commission (“SEC”) adopted Rule 14a-11 of the Securities and Exchange Act of 1934 (“Exchange Act”) on August 25, 2010.<sup>1</sup> The rule was intended to provide shareholders with the ability to more effectively nominate and elect directors to the boards of directors of publicly reporting companies. Specifically, the rule would have allowed shareholders holding at least 3% of the outstanding shares of a company continuously for three years to nominate a director for inclusion using the company’s proxy solicitation materials. Rule 14a-11 was supposed to become effective in mid-November 2010, but it was put on hold by the SEC, pending the outcome of litigation filed by the Business Roundtable and the U.S. Chamber of Commerce.

This morning, the U.S. Court of Appeals for the D.C. Circuit (the “Court”) issued an opinion in the case.<sup>2</sup> In a unanimous decision, the Court vacated Rule 14a-11, concluding that the SEC had acted “arbitrarily and capriciously” in promulgating the rule by failing to properly consider its potential economic effects. The Court found that the SEC had neglected both to quantify the costs that companies would incur in opposing shareholder nominees and to substantiate the rule’s predicted benefits. It also found that the SEC had failed to consider the consequences of union and state pension funds using the rule and had failed to properly evaluate the frequency with which shareholders would initiate election contests.

Further, using particularly harsh language, the Court found that the SEC’s decision to apply Rule 14a-11 to investment companies failed adequately to address whether the regulatory requirements of the Investment Company Act reduced the need for, and hence the benefit to be derived from, proxy access for shareholders of investment companies and whether the rule would impose greater costs on investment companies by disrupting the structure of their governance.<sup>3</sup> Finding that since the Court held the rule to be arbitrary and capricious it was “assuredly invalid” as applied specifically to investment companies, the Court described the SEC’s rationale for doing so as “unutterably mindless.”<sup>4</sup>

With Rule 14a-11 having been vacated, the SEC must decide whether to redo its analysis and re-promulgate the rule or wait for Congress to devise a statutory means by which to enhance shareholders’ ability to access the proxy process.

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<sup>1</sup> Release Nos. 33-9136; 34-62764; IC-29384; File No. S7-10-09, *Facilitating Shareholder Director Nominations* (Aug. 25, 2010), available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>. See also our firm memorandum, *SEC Adopts New Rules Strengthening Shareholders’ Ability to Nominate Members of the Board of Directors* (Sept. 3, 2010), available at [http://www.cahill.com/news/memoranda/100232/res/id=sa\\_File1/CGR%20Memo%20-%20SEC%20Adopts%20New%20Rules%20Strengthening%20Shareholders%27%20Ability%20to%20Nominate%20Members%20of%20the%20Board%20of%20Directors.pdf](http://www.cahill.com/news/memoranda/100232/res/id=sa_File1/CGR%20Memo%20-%20SEC%20Adopts%20New%20Rules%20Strengthening%20Shareholders%27%20Ability%20to%20Nominate%20Members%20of%20the%20Board%20of%20Directors.pdf).

<sup>2</sup> See *Business Roundtable and Chamber of Commerce of the United States of America v. SEC*, Case No. 10-1305 (July 22, 2011), available at [http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf) (“Slip Opinion”).

<sup>3</sup> Slip Opinion at 18.

<sup>4</sup> *Id.* at 21.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com); or Abigail Darwin at 212.701.3240 or [adarwin@cahill.com](mailto:adarwin@cahill.com).

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