



D.C. COURT OF APPEALS STRIKES DOWN SEC'S PROXY RULE

In July 2011, in ruling on a petition by The Business Roundtable and the U.S. Chamber of Commerce, the United States D.C. Court of Appeals, struck down an SEC rule that would have required public companies to provide shareholders with information about, and an ability to vote for, shareholder-nominated candidates for boards of directors.

The rule, which was controversial from the beginning, was adopted by the SEC in a 3-2 party line vote in August 2010¹. The rule would have permitted a shareholder (or a group of shareholders) who had no intention of seeking a change in control to include a nominee or nominees for election to the board in a company's proxy materials if the nominating shareholder had continuously held shares equal to at least 3% of the company's outstanding voting shares for at least three years. The rule would have permitted shareholders to nominate at least one director and up to a number of directors that represents not more than 25% of the total number of the company's directors.

The court agreed with the petitioners' argument that the SEC acted "arbitrarily and capriciously" for failing to adequately assess the economic effects of the new rule. The court's ruling focused on principles of administrative law, finding violations of the Administrative Procedure Act because the SEC did not adequately consider the rule's effect on efficiency, competition and capital formation. The court strongly criticized the

SEC rule-making process, finding that the SEC inconsistently and opportunistically framed the costs and benefits of the rule. A copy of the opinion can be found [here](#).

The ruling is viewed by many as a victory for public companies and their shareholders. It keeps in place (for the time being), the current system of board elections. Unhappy shareholders are still free to conduct proxy contests but in order to do so they must pay for the expense of filing and disseminating their own proxy materials. One of the business community's concerns about the proxy access rule was that the single issue shareholders (such as union and state pension funds) would use the rule as leverage to gain concessions, such as additional benefits for union employees, unrelated to long-term shareholder value.

Meredith Cross, Director of the SEC's Division of Corporation Finance, issued a statement on July 22, 2011:

We are disappointed by today's decision striking down a rule that made it easier for shareholders to nominate a candidate to a company's board of directors. We are considering our options going forward. We note that our rule allowing shareholders to submit proposals for proxy access at their companies, which we adopted at the same time, is unaffected by the court's decision.

When the SEC adopted Rule 14a-11 (proxy access) in August 2010, it also adopted an amendment to Rule 14a-8 (referred to above in Ms. Cross's statement regarding

¹ Pending the outcome of the petitioners' court challenge, in November 2010, the SEC voluntarily stayed the application of the proxy access rule (14a-11) and an amendment to Rule 14a-8 dealing with shareholder proposals.

shareholder proposals on proxy access). In amending Rule 14a-8, the SEC explicitly reversed a prior position it had taken since 2007 by allowing a shareholder to use the shareholder proposal mechanism to require a company to include in its proxy materials a shareholder proposal that amends, or requests an amendment to, the company's governing documents to address the company's nomination procedures or other director nomination disclosure provisions. The Rule 14a-8 amendment, which was voluntarily stayed by the SEC (see footnote 1), was not covered by the court's decision. Therefore, the SEC could lift the stay on Rule 14a-8 at any time.

The SEC now needs to decide how to proceed.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 gave the SEC the explicit authority to adopt rules allowing shareholders to include director nominees in the company's proxy materials. The SEC's choices appear to be: (1) appeal the court's decision; (2) propose new proxy access rules that address the court's concerns; or (3) do nothing and allow private ordering under state corporation laws to continue to govern board elections. The SEC must also decide how to proceed with the stayed Rule 14a-8 amendment. Regardless of how the SEC decides to proceed, it does not appear that shareholder proxy access will apply to the 2012 proxy season.

ADDITIONAL INFORMATION

For more information regarding the court's ruling or proxy matters generally, please get in touch with your Tucker Ellis & West LLP contact or one of the following attorneys:

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