SEC Advisory

From the Buchanan Ingersoll & Rooney Corporate Finance & Technology Section

Buchanan Ingersoll & Rooney PC
Attorneys & Government Relations Professionals

July 2011

U.S. Appeals Court Strikes Down SEC's Proxy Access Rules

On July 22, 2011, the U.S. Court of Appeals for the District of Columbia Circuit invalidated the Securities and Exchange Commission's controversial "proxy access" rule (promulgated under Rule 14a-11 of the Securities Exchange Act of 1934, as amended), which would have required public companies to include a shareholder-nominated director candidate in their proxy materials for an annual meeting (or special meeting in lieu of the annual meeting) so long as the nominating shareholder or group of shareholders holds at least three percent (3%) of the voting power of the company's securities entitled to be voted at the meeting for at least three years prior to the date the nominating shareholder or group submits its notice of intent to use the rule and continues to own those securities through the date of the meeting.

The SEC delayed implementing Rule 14a-11, which would have otherwise become effective on November 15, 2010, after the U.S. Chamber of Commerce and the Business Roundtable filed a lawsuit in September 2010, arguing that the Securities and Exchange Commission (SEC) had acted arbitrarily and capriciously by neglecting its statutory responsibility to determine the likely economic consequences of Rule 14a-11 and to connect those consequences to efficiency, competition and capital formation. They also argued that the Commission's decision to apply Rule 14a-11 to investment companies was arbitrary and capricious.

On Friday, the court, agreeing with the petitioners, vacated the rule. The three judge panel concluded that the SEC had acted “arbitrarily and capriciously” in approving Rule 14a-11 by failing to adequately assess the economic effects of the new rule on companies. Judge Douglas Ginsburg, who wrote the opinion for the court, said that the SEC "relied upon insufficient empirical data" in determining that the new rule would "improve board performance and increase shareholder value by facilitating the election of dissident shareholder nominees." He further noted that the SEC has "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why these costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters."

The court also criticized the Commission for its failure to address concerns that investors with special interests, such as unions and state and local governments whose interests in jobs may well be greater than their interest in share value, could use the new rules to pursue self-interested objectives and cause companies to incur costs even when their nominee was unlikely to be elected.

The court also found that the Commission's decision to apply the rule to investment companies was arbitrary and capricious, particularly in light of the enhanced regulation imposed by the Investment Company Act of 1940.

The SEC now has the option of re-promulgating the proxy access rules or appealing the court's decision to the U.S. Supreme Court. It is not clear at this time whether the SEC will take either of these steps.

For questions or more information, contact one of the members of the firm's Securities/SEC Practice Group including:

Ronald Basso — 412 562 3943 :: ronald.basso@bipc.com
Lewis U. Davis, Jr. — 412 562 8953 :: lewis.davis@bipc.com
Hannah T. Frank — 412 562 1546 :: hannah.frank@bipc.com
Jeremiah G. Garvey — 412 562 8811 :: jeremiah.garvey@bipc.com
Jennifer R. Minter — 412 562 8444 :: jennifer.minter@bipc.com
Brian S. North — 215 665 3828 :: brian.north@bipc.com
Brian S. Novosel — 412 562 5266 :: brian.novosel@bipc.com