Court Strikes Down SEC "Proxy Access" Rule

On Friday, July 22, 2011, the United States Court of Appeals for the D.C. Circuit issued its opinion in the case of *Business Roundtable and Chamber of Commerce vs. Securities and Exchange Commission* vacating the SEC's so-called "proxy access" rule. This rule, which was adopted by a 3-2 vote of the Commission in August 2010, would have permitted a shareholder (or group of shareholders) owning at least 3% of a public company's voting securities for at least three years to nominate one or more candidates to serve on the company's board of directors and have that candidate's name (or candidates' names) appear in the company's proxy materials.

In September 2010, the Business Roundtable and the United States Chamber of Commerce filed a petition for review of the proxy access rule, asserting that the process by which the SEC had adopted the rule was flawed because if failed to adequately consider the rule's costs, benefits, and economic impact. Notably, the petitioners did not challenge the Commission's authority to adopt a proxy access requirement; primarily because Section 971 of the Dodd-Frank Wall Street Reform and Consume Protection Act expressly authorized the SEC to promulgate such a rule. Shortly thereafter, the SEC agreed to postpone the effective date of the rule, pending resolution of the petition for review.

In striking down the rule by a vote of 3-0, the Court held that the SEC had acted "arbitrarily and capriciously" by not considering all of the economic consequences of the rule. For example, the Court cited the Commission's failure to evaluate the potential costs that companies would incur opposing shareholders' director nominees. Additionally, in the Court's view, the SEC did not adequately substantiate its assertion that the new rule would enhance Board performance.

At this point, it's too early to predict the Commission's likely response to the Court's decision. There are at least four possible options available to the agency:

- Seek a rehearing before the entire D.C. Circuit;
- Appeal the decision to the United States Supreme Court;
- Rewrite (and readopt) the rule to address the issues identified by the Court; or
- Abandon the rule project altogether.

The judicial alternatives are not necessarily the most attractive since either approach would require the consent of the applicable court. Further, given the amount of time and energy that the SEC has expended on this rule over the last decade and the likely outcry from shareholders and investor advocates, abandoning the project would be a significant embarrassment for the Commission. And, while redrafting the rule appears to be the most pragmatic choice, at the moment the agency is struggling to keep up the rulemaking projects mandated by the Dodd-Frank Act and probably doesn't have the bandwidth to take on this highly visible – and controversial – project at the present time.

At the moment, probably the only thing that can be stated with any reliability is that proxy access is unlikely to be effective during the 2012 proxy season.

Although the SEC's new proxy access rule has been invalidated, the amendments to Exchange Act Rule 14a-8, which were adopted by the Commission at the same time, were not affected by the Court's decision. Accordingly, if the SEC proceeds to declare this provision effective in time for the 2012 proxy season, shareholders will be able to submit proposals seeking to amend a company's by-laws to permit director-nominees submitted by shareholders to be included in the company's proxy materials.

Need Assistance?

Compensia has had significant experience in helping companies to understand the impact of the SEC's rules on their executive compensation programs. If you have any questions on the subjects addressed in this Thoughtful Pay Alert or would like assistance in assessing their likely impact on your executive com¬pensation plans and arrangements, please feel free to contact us.■

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