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Alert

Corporate Finance and Securities Client Service Group

Securities Litigation and Enforcement Group

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SEC Proxy Access Rule Vacated by Federal Court

The U.S. Court of Appeals for the District of Columbia Circuit recently set aside and vacated Exchange Act Rule 14a-11 concerning shareholder proxy access, adopted by the Securities and Exchange Commission ("SEC") on August 25, 2010. On a petition for review filed by the Business Roundtable and U.S. Chamber of Commerce, a unanimous three judge panel held that the SEC had "failed adequately to consider the rule's effect upon efficiency, competition and capital formation," as the SEC was required to do under its enabling statutes. Thus, the Court held that adoption of the Rule was "arbitrary and capricious" and vacated the Rule.

Under the Dodd-Frank Act, enacted in July 2010, the SEC has authority to prescribe rules to require companies to include in their proxy materials director candidates nominated by shareholders. Rule 14a-11, issued under this authority, provides that eligible shareholders could require a company to include one or more nominees in the company's proxy materials, unless applicable laws or corporate governance documents prohibited shareholder nominations. The Rule further provides the threshold requirements that shareholders must meet to invoke the Rule, defining the criteria nominees for the board must meet, and setting forth the notice and disclosure requirements when a nomination is made. (See the Bulletin we issued in August, 2010, with a detailed explanation of the Rule, found here.)

At the same time that the SEC adopted Rule 14a-11, it also amended Rule 14a-8 to prevent companies from excluding from their proxy materials shareholder proposals to establish a procedure for shareholders to nominate directors. This companion rule was not challenged, and the Court did not alter or comment on Rule 14a-8 as amended.

The Court's July 25 decision does not preclude the SEC from reconsidering adoption of Rule 14a-11, as the Court's holding was essentially that the Commission had failed to perform a reasoned cost benefit analysis in adopting the Rule. As to both costs and benefits, the Court described the Commission's rationale as speculative, inadequate or inconsistent. In particular, the Court criticized the application of the Rule to Investment Companies, accepting industry arguments that the SEC failed to consider unique aspects of the board structure of such entities. The Court's decision requires that in any new

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rule making, the SEC provide a more detailed and rational analysis of the economic consequences and costs of the Rule as measured quantitatively against its benefits. While that task likely would require the SEC to do more information gathering and analysis, readopting a rule that would satisfy the D.C. Circuit would seem possible given the legal flaw that the Court identified.

Beyond issuing a statement that it was "disappointed" in the outcome of the case, the SEC has not indicated when or if it will reconsider the proxy access issue. It is unlikely that a new version of the Rule could be adopted in less than a year. The decision is one of several in recent years in which the District of Columbia Circuit has invalidated SEC rules. For example, in 2010, in *American Equity Investment Life Insurance Company v. SEC*, the D.C. Circuit vacated an SEC rule purporting to regulate fixed indexed annuities because the SEC had failed to perform a reasonable cost benefit analysis of that rule (Bryan Cave lawyers were involved in that case for the prevailing petitioners).

The *American Equity* and Rule 14a-11 cases provide something of a roadmap for potential challenges to the rules that the SEC and other agencies may promulgate under other Dodd-Frank provisions. In the Rule 14a-11 case, the Court criticized the SEC for failing to fully analyze arguments offered in comment letters. In both cases, there were dissenting opinions of SEC commissioners. This counsels that parties who are adversely affected by a proposed rule should consider submitting a carefully crafted comment letter, with particular emphasis on the costs and benefits of the rule. Further, meetings with individual Commissioners - - particularly those who might be sympathetic to a party's position - - should be considered in order to obtain possible helpful modifications to the rule when adopted in final form or, at a minimum, to provide substantive arguments that might be reflected in a potential dissent to adoption of the rule, which might prove of assistance in a subsequent judicial challenge.

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