# PUBLICATION

## The Debate Over Proxy Access Rules Continues

**July 28, 2011**

On July 22, 2011, the United States Court of Appeals for the D.C. Circuit struck down Securities and Exchange Commission (SEC) Exchange Act Rule 14a-11, which had mandated shareholder proxy access, allowing for shareholders of a public company to include their nominations for election to the company's board of directors in the company's proxy statement and on the company's proxy card. This rule - which was in contrast to the traditional approach in which the shareholders prepared, mailed and paid for their own proxy materials - had been challenged by the Business Roundtable and U.S. Chamber of Commerce, among others, who argued that the SEC failed to look at the true costs the rule would impose on public companies.

In its opinion, the court stated that implementation of the rule by the SEC was an "arbitrary and capricious" use of its power. Judge Ginsburg rebuked the SEC in his opinion for having "failed once again…adequately to assess the economic effects of a new rule." As a further blow to the SEC, the court went out of its way to address the invalidity of the rule to investment companies. The court recognized that investment companies are already subject to the enhanced regulation of the Investment Company Act of 1940 and further, that costs associated with the rule could be much higher to an investment company by threatening to disrupt its structure of corporate governance.

**Background**

As part of the regulatory reaction to the recent financial crisis, proxy access rules became a topic of much debate. In 2009, Delaware adopted a new Section 112 of the Delaware General Corporation Law, becoming the first state to institute a proxy access statute. Section 112 allowed for, but did not require, Delaware corporations to include in their bylaws provisions which would require the corporation to include in its proxy statement the shareholder-nominated director candidates.

Following a similar but more stringent approach, on August 25, 2010, the SEC adopted Rule 14a-11, which mandated shareholder proxy access. The SEC and several shareholder advocates championed the rule, seeking to gain simplified access to corporate boards. The Business Roundtable, the U.S. Chamber of Commerce and others challenged the rule, arguing that the SEC failed to look at the true costs the rule would impose on public companies.

Pending the decision of the court, the SEC granted a stay on the rule, making it ineffective for the 2011 proxy season.

**What's Next**

The SEC's response to this recent setback is uncertain. At the same time it implemented Rule 14a-11, the SEC also adopted Rule 14a-8 which allows shareholders to propose additional procedures for board access beyond Rule 14a-11. Although Rule 14a-8 was also stayed by the SEC pending the most recent ruling, Rule 14a-8 was not part of the challenge and the SEC may choose to let it become effective. In its ruling, the court failed to reach the First Amendment claims of the Business Roundtable and Chamber of Commerce, who argued that forcing a corporation to fund and carry a campaign speech by third parties violated the First Amendment rights of the corporation. As a result, the SEC may now go back to the drawing board and attempt to design a rule that would take the place of the now defunct Rule 14a-11. The SEC has not publicly announced how it will move forward after this ruling. However, it is unlikely that public companies will need to conform to the proxy access rules of Rule 14a-8 or Rule 14a-11 for the 2012 proxy season. We do anticipate some type of amendment to Rule 14a-11 and/or the implementation of Rule 14a-8 to be in the works shortly.

If you have questions about this ruling or any other SEC rules, please contact your Baker Donelson attorney.