

# Client Alert.

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## SEC Will Not Appeal Proxy Access Decision; Shareholder Proposal Amendments Will Take Effect

By David M. Lynn and Scott G. Hodgdon

On September 6, 2011, Mary L. Schapiro, Chairman of the Securities and Exchange Commission (“SEC”), issued a statement<sup>1</sup> indicating that the SEC would not seek rehearing of the recent decision of the United States Court of Appeals for the District of Columbia Circuit (the “Court”) that vacated the SEC’s “proxy access” rule, nor would the SEC seek Supreme Court review.<sup>2</sup> Chairman Schapiro also indicated that the amendment to existing Rule 14a-8, adopted with Rule 14a-11, which provides that companies may not exclude from their proxy materials shareholder proposals for proxy access procedures, will go into effect when the Court’s decision is finalized, which is expected to be on September 13, 2011.

### RULE 14A-11 – THE VACATED PROXY ACCESS RULE

As adopted, Rule 14a-11 would have provided qualifying shareholders or groups holding at least three percent of the voting power of a company’s securities, and who have held their shares for at least three years, with the ability to request that public companies or investment companies include the shareholder or shareholders’ director nominees in their proxy materials, upon meeting certain other requirements. The rule would have applied to public companies and investment companies.

Rule 14a-11 was adopted shortly after Section 971 of the Dodd-Frank Act clarified the SEC’s authority to promulgate the rule. In September 2010, the Business Roundtable and Chamber of Commerce of the United States of America filed a petition with the Court seeking judicial review of the changes to the SEC’s proxy access and related rules. In October 2010, the SEC granted a stay of the rules pending resolution of the petition for review by the Court.

In its July 22, 2011 decision, the Court held that the SEC was arbitrary and capricious in adopting the rule and indicated that the SEC failed to adequately address the economic effects of Rule 14a-11. The Court expressed significant concerns about the conclusions that the SEC reached and the agency’s consideration of comments during the course of the rulemaking.

The SEC confirmed that it would neither seek a rehearing of the decision that vacated Rule 14a-11, nor would it appeal the decision to the U.S. Supreme Court. In her statement, Chairman Schapiro reiterated her support for proxy access, noting that “it is a process that helps make boards more accountable for the risks undertaken by the companies they

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<sup>1</sup> See *Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation*, available at <http://www.sec.gov/news/press/2011/2011-179.htm>

<sup>2</sup> See our *July 22, 2011 client alert on the decision, SEC Proxy Access Rule Vacated*, available at

<http://www.mofo.com/files/Uploads/Images/110722-SEC-Proxy-Access-Rule-Vacated.pdf>

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manage.” She noted, however, that she wants “to be sure that we carefully consider and learn from the Court’s objections as we determine the best path forward.” While the statement does not foreclose the possibility of the SEC revisiting the issue of proxy access, it appears that the SEC staff will spend some time reviewing not only the Court’s decision but also comments the SEC had previously received from commenters.

## **RULE 14A-8 AMENDMENTS – “PRIVATE ORDERING”**

The Court’s decision did not address the SEC’s amendment to Rule 14a-8(i)(8), which was adopted at the same time as Rule 14a-11 but was not a subject of the litigation. These amendments to the existing shareholder proposal rule permit the type of “private ordering” for proxy access through the shareholder proposal process that many commenters had supported in the course of the proxy access rulemaking. Under the amendments to Rule 14a-8, a company may no longer exclude a proposal that would amend or request that the company consider amending governing documents to facilitate director nominations by shareholders or disclosures related to nominations made by shareholders, as long as such proposal is not otherwise excludable under some other procedural or substantive basis in Rule 14a-8. The SEC also codified some of the Staff’s historical interpretations of 14a-8(i)(8) which permitted exclusion of a shareholder proposal that would: (1) seek to disqualify a nominee standing for election; (2) remove a director from office before the expiration of his or her term; (3) question the competence, business judgment or character of a nominee or director; (4) nominate a specific individual for election to the board of directors, other than an applicable SEC provision, an applicable state law provision, or an issuer’s governing documents; or (5) otherwise affect the outcome of the upcoming election of directors. As a result of the SEC’s amendment of Rule 14a-8(i)(8), shareholders will have the opportunity to establish proxy access standards on an individual company-by-company basis, rather than the “universal” approach that had been contemplated by Rule 14a-11.

The status of the amendments to Rule 14a-8 was unclear following the Court’s decision to vacate Rule 14a-11. In the wake of the Court’s decision, the SEC issued a statement from the Director of the Division of Corporation Finance indicating that the SEC staff was disappointed with the Court’s decision and stating that they were considering their options. The statement also noted that the amendments to Rule 14a-8(i)(8), adopted at the same time as Rule 14a-11, were unaffected by the Court’s decision.

The SEC’s October 2010 stay order provides that the stay of the effective date of Rule 14a-8 and related rules will expire without further SEC action when the Court’s decision is finalized, which the SEC expects to be on September 13, 2011. The SEC has now indicated that, absent further action by the SEC, the Rule 14a-8 amendments will go into effect and a notice of the effective date of such amendments will be published.

## **WHAT’S NEXT**

Prior to Chairman Schapiro’s statement, the future of proxy access was unclear. Now that the SEC has confirmed that it will not appeal the Court’s decision on Rule 14a-11, there is no longer uncertainty about whether the Rule 14a-11 approach could potentially be revived in time for the upcoming proxy season. Even though Chairman Schapiro’s statement demonstrates that she remains committed to proxy access, her request that the SEC staff continue reviewing the Court’s decision and the previously received comments indicates that it will likely be some time before the SEC revisits the issue of proxy access.

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Chairman Schapiro's statement also clarifies the future of the amendments to Rule 14a-8, left unclear following the Court's ruling. As these amendments will become effective shortly, the "private ordering" approach to proxy access should be on every public company's list of significant issues for the upcoming proxy season. Shareholders who have expressed disappointment in the Court's decision to vacate Rule 14a-11 may use the mechanism provided by Rule 14a-8(i)(8) to seek to establish a proxy access regime at individual companies. Companies gearing up for the proxy season should plan accordingly.

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