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D.C. Circuit Vacates SEC Proxy Access Rules

The Court of Appeals for the District of Columbia, in a strongly worded opinion, has today vacated the SEC's proxy access rules (set forth in Rule 14a-11) as being arbitrary and capricious and therefore in violation of the Administrative Procedure Act. In so doing, the Court found that the SEC failed adequately to consider the economic implications of the rules and their effect on efficiency, competition and capital formation.

In reaching its decision, the Court found that the SEC, among other things,

- did not quantify the costs that companies would incur in opposing shareholder nominees (*e.g.*, the costs may be higher than the SEC had anticipated because boards may be compelled by their fiduciary duty to oppose inappropriate shareholder nominees);
- did not substantiate the rules' predicted benefits (*e.g.*, improperly discounting studies that showed that the rule would not improve board performance and shareholder value and instead relying on two "relatively unpersuasive" studies that showed the opposite effect);
- did not consider the consequences of certain shareholders (such as unions and state pension funds) using the rules to further their special interests to the detriment of broader shareholder value;
- underestimated the frequency with which shareholders would initiate election contests under the rules; and
- applied the rules to investment companies notwithstanding the "probability that the rule[s] will be of no net benefit as applied to investment companies."

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. Given the strong business opposition and the fact that these rules are already the result of a very long and arduous rulemaking process, it is unclear whether the SEC will take either of these steps.

As was noted by the Court, this is the third time in recent years that the D.C. Circuit has vacated an SEC rulemaking.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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