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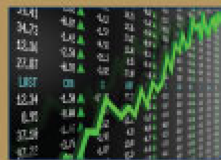

UPDATE
Business Transactions

DECEMBER 2011

SEC's Proxy Access Rule Vacated; Shareholder Proposals Regarding Proxy Access Permitted

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In what has been described as a sharp rebuke to the Securities and Exchange Commission, an appellate court in Washington D.C. ruled that the SEC's proposed Rule 14a-11, commonly known as the "proxy access" rule, was promulgated in violation of the Administrative Procedures Act. The SEC has decided not to appeal the ruling, so, for the upcoming proxy season, shareholders will not have the ability pursuant to the rule to have nominees included in a public company's proxy statement.

BACKGROUND

Pursuant to its authority granted by the Dodd-Frank financial overhaul, the SEC proposed Rule 14a-11. The proxy access rule would have allowed investors or shareholder groups owning at least three percent of a public company's stock for at least three years to nominate their own director candidates and to have those nominees included on the company's proxy statement. Concurrent with the promulgation of Rule 14a-11, the SEC proposed an amendment to Rule 14a-8 that would prohibit companies from excluding from their proxy materials shareholder proposals for less restrictive proxy access procedures. Both rules were to become effective in November 2010. The SEC promoted the proposed proxy access rule as a vehicle to provide shareholders with an alternative path for nominating and electing directors without the expense of a traditional proxy fight, leading to improved board and company performance and, therefore, an increase in value.

In September 2010, the Business Roundtable and the Chamber of Commerce petitioned the United States Court of Appeals for the District of Columbia Circuit, seeking judicial review of Rule 14a-11 but not of the amendment to Rule 14a-8. In response, the SEC stayed the effective date of the rules. The Business Roundtable and the Chamber of Commerce argued, among other things, that the proposed rule change would allow minority shareholders and special interest groups too much clout in corporate boardrooms, to the detriment of the companies.

Under the Administrative Procedures Act, federal agencies, such as the SEC, are required to weigh the economic impact of proposed regulations, to avoid taking capricious or unpredictable actions, and to respond to substantive comments raised during comment periods, as well as to ensure that regulations are not an abuse of the discretion granted to the agency. The SEC is also required by law to study the effect of its proposed rules on efficiency, competition, and capital formation.

THE COURT'S REASONING AND FINDINGS

In striking down the proposed rule, the court found that the SEC violated the Administrative Procedures Act by failing in its duty to properly consider the rule's effect upon efficiency, competition, and capital formation. The court found that the SEC failed its unique obligation to adequately assess the economic effect of the proposed change and to apprise itself, and thus, the public and Congress, of the economic consequences of the proposed regulation. Specifically, the court found that the SEC did not consider the costs to corporations of contested elections and of opposing shareholder nominees, that the SEC relied on insufficient empirical data to support its conclusions, and that it failed the consider how unions and large pension funds might use Rule 14a-11 as leverage to gain concessions or additional benefits unrelated to shareholder value. The court held that the rule was arbitrary and capricious, in part, because the SEC's own internal discussions on the impact of the rule were inconsistent. The court opined that the "Commission inconsistently and opportunistically framed costs and benefits of the rule, failed to adequately quantify certain costs or explain why those costs should not be quantified, neglected to support predictive judgments, contradicted itself, and failed to respond to substantive problems raised by commenters."

EFFECT OF RULING

Although the court's decision was strongly critical of the SEC's rule-making methodology, the court neither considered nor ruled on the SEC's authority to regulate proxy access. Therefore, the court's decision does not prevent the SEC from revamping and reissuing a new rule; it does, however, set a high bar for the SEC to meet. The SEC has expressed disappointment with the court's decision but has decided not to appeal the court's ruling. It is important to note, however, that the SEC may still revisit the issue in the future. Also, it should be noted that the amendment to Rule 14a-8 was not challenged and is unaffected by the court's decision. This means that shareholders now have the right to submit proposals to be added to proxy materials for less restrictive proxy access policies, and companies will be required to disseminate the proposals to shareholders for their consideration. In anticipation of receiving such proposals, companies may want to consider adopting their own proxy access mechanism to make proxy access less restrictive. The amended Rule 14a-8 will make proxy reform a company-by-company issue, unless the SEC puts forth a revamped Rule 14a-11. We believe most companies will adopt a wait-and-see approach, at least for the 2012 proxy season.

CONTACT

If you have any questions about these rules and how your company may be affected, please contact Edward J. Samorajczyk, Jr., at 860-275-8207 in our Hartford office. Keisha S. Palmer was instrumental in assisting in the preparation of this update.

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