SEWARD & KISSEL LLP

Activist Investor Report

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This newsletter highlights selected key developments in US securities laws and regulations and other legal developments affecting activist shareholders of publicly traded companies.

D.C. Circuit Court of Appeals Vacates SEC's Proxy Access Rule

On July 22, 2011, the United States Court of Appeals for the District of Columbia (the "Court") vacated Rule 14a-11 under the Securities Exchange Act of 1934 (the "Exchange Act"), commonly referred to as the proxy access rule, holding that the SEC acted "arbitrarily and capriciously" in promulgating the rule by failing to adequately assess the rule's economic effects (*Business Roundtable and Chamber of Commerce v. SEC*, D.C. Cir., No. 10-1305, July 22, 2011).

Background of Rule 14a-11

In August 2010, the SEC adopted Rule 14a-11 in a three-to-two vote pursuant to its authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act. As discussed in a prior Activist Investor Report, as adopted, Rule 14a-11 would have required companies subject to the Exchange Act proxy rules, including investment companies registered under the Investment Company Act of 1940, to include in their proxy materials director candidates nominated by shareholders meeting certain ownership and other requirements.

Rule 14a-11 was scheduled to take effect on November 15, 2010 and would have applied generally to shareholder meetings during 2011 for companies whose 2010 proxy materials were mailed on or after March 15, 2010. However, in October 2010, the SEC stayed the effectiveness of the rule pending the outcome of the Court's review of the petition filed by the Business Roundtable and the U.S. Chamber of Commerce.

The Court's Decision

In *Business Roundtable*, the Court held the SEC violated the Administrative Procedures Act in adopting Rule 14a-11 because it failed to evaluate the rule's economic consequences and the effect of such consequences on "efficiency, competition and capital formation," as required by the Exchange Act. In particular, the Court concluded that the SEC, among other things, failed to adequately quantify certain costs associated with the rule's implementation, such as the costs companies may incur in connection with additional contested elections, or to explain why such quantification was not possible. The Court also found that the SEC neglected to support its predictions and failed to address problems with the rule raised by commenters.

The Court faulted the SEC for relying on "insufficient empirical data" in its conclusion that Rule 14a-11 would improve board performance and enhance shareholder value by facilitating the election of dissident shareholder director nominees. Numerous studies were submitted by commenters supporting the opposite conclusion, but the SEC relied on two studies that the Court found to be unpersuasive.

In addition, the Court found that, despite receipt of public comments on the subject, the SEC failed to evaluate the potential costs associated with use of the rule by institutional investors with special interests, such as unions and state and local governments. The Court also criticized the SEC's cost-benefit analysis, finding that because the SEC failed to consider the impact of the final rule on the total number of director election contests, the SEC could not determine whether the rule would facilitate enough election contests to be beneficial.

Furthermore, the Court deemed the SEC's analysis of the estimated frequency of nominations under Rule 14a-11 inconsistent because it assumed frequent use of the rule to estimate benefits but infrequent use to estimate costs.

Aftermath of the Court's Decision

The SEC has not publicly announced whether it will attempt to re-adopt Rule 14a-11 or pursue any other proxy access rulemaking initiatives. Any attempt to do so would presumably require a new proposal and opportunity for public comment. Accordingly, it is unlikely that any new proxy access rules will be in effect for the 2012 proxy season.

However, the amendments to Rule 14a-8 under the Exchange Act that were adopted by the SEC in 2010, which prohibit companies subject to the Exchange Act proxy rules from excluding shareholder proposals that seek to establish procedures for nominations of directors by shareholders, are unaffected by the Court's holding in *Business Roundtable*. While these amendments were also subject to the October 2010 stay, the SEC may decide to lift the stay on these amendments in time for the 2012 proxy season, which would permit companies and their shareholders to adopt proxy access rules by private action.

We will continue to update you as there are further developments related to the proxy access rule.

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