

Investor Alert

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COURTS SIDING WITH SEC REGARDING PROXY ADVICE REFORM

Background

As discussed in a previous Labaton Sucharow LLP [Investor Alert](#), on July 13, 2022, the Securities and Exchange Commission voted to adopt amendments to its rules governing proxy-voting advice,¹ voting to partially rescind a set of rules enacted during the Trump administration that “made it somewhat more difficult for investors to influence public companies via shareholder voting.”² The prior rules enacted in 2020 increased restrictions on proxy-voting advice businesses (“PVABs” or “proxy-advisory firms”), which advise institutional investors on how to vote their shares in a proxy contest.³

Specifically, on July 13, 2022, the SEC rescinded and eliminated two rules which were passed in 2020:

- ◆ requiring proxy-advisory firms to make their vote recommendations available to the public company no later than when the advice is disseminated to the proxy-advisor’s clients; and
- ◆ requiring proxy-advisory firms to provide their clients with a “mechanism” for becoming aware of the public company’s written response to the proxy-advisory firm’s recommendation – essentially requiring a proxy-advisory firm to provide the institutional investors with the company’s response to their advice (together, the “2020 Rules”).

Institutional investors and PVABs expressed concerns that the independence of the investor’s vote was jeopardized by the 2020 Rules since functionally, “proxy advisory firms *may feel pressure to tilt voting recommendations in favor of management* more often, to avoid critical comments from companies that could draw out the voting process and expose the firms to costly threats of litigation.”⁴ There were also concerns of the potential for increased compliance costs for PVABs and the timeliness of the recommendations they give.

Two Recent Decisions: Court Denies Summary Judgment

Multiple entities, including the Chamber of Commerce and the Business Roundtable, have filed suits against the SEC challenging the rescission and elimination of the business-friendly 2020 Rules. Two actions, *Chamber of Commerce of the United States of America et al. v. SEC*, No. 22-cv-00561, 2023 WL 3063819 (M.D. Tenn. Apr. 24, 2023) and *National Association of Manufacturers et al. v. SEC*, No. 22-cv-00163, 2022 WL 17420760 (W.D. Tex. Dec. 4, 2022), reached the summary judgment stage of the litigation.

Notably, both courts denied the plaintiffs’ motion for summary judgment against the SEC—and granted defendant SEC’s motion for summary judgment—ruling

¹<https://www.sec.gov/news/press-release/2022-120>

²<https://www.wsj.com/articles/sec-mulls-changes-to-proxy-voting-advice->

[shareholder-proposals-11657720813](#)

³ *Id.*

⁴https://www.cii.org/july22_sec_proxy_advice_rules (emphasis added)

in favor of the SEC's rescission of the 2020 Rules. The outcome of both decisions is discussed in greater detail below.

Chamber of Commerce et al. v. SEC

The plaintiffs asked the court to set aside the 2022 amendments on the grounds that they were adopted in violation of the Administrative Procedure Act ("APA"). The Court found the SEC acted appropriately in carrying out the 2022 reversal of the 2020 Rules, rejecting the plaintiffs' arguments that the agency should have "asserted more aggressively that its prior analysis [regarding the 2020 Rules] was unacceptably flawed," finding that this would have been an exercise in "empty theater that would, if anything, obfuscate matters."⁵ Amongst other things, the most notable takeaway from the court's decision in this regard is below:

The question of which way any "political winds" were blowing at any given time is beyond this court's knowledge. The Western District's statement, however, correctly identifies what this case actually is about: a change in the SEC's policy preference, plain and simple. The SEC did not provide a record showing that its 2020 reasoning had been definitively debunked, because that is neither what happened nor what was required to happen for the SEC to act. ***Rather, the SEC reconsidered a matter and came down on a different side of a debatable question, which it was permitted to do***, and then it explained that decision clearly and thoroughly, as was required. Because the

SEC explained in sufficient scope and detail why it concluded that the 2022 policy was preferable, it satisfied the general APA obligations at the heart of Counts III and IV. The court accordingly will grant the defendants summary judgment on those counts.⁶

The Court also found that the SEC "fully identified and explained the concerns on both sides of the issue and set forth its conclusion regarding which was more persuasive."⁷ The Court thereby granted the SEC's motion for summary judgment.

National Association of Manufacturers et al. v. SEC

Likewise, the Court in *National Association of Manufacturers* analyzed whether the SEC's decision to rescind the proxy voting advice conditions was "reasonable and reasonably explained" as required under the APA.⁸ The Court held that the SEC's 2022 rescission of the 2020 Rules was within "the bounds of reasoned decision making."⁹

The Court concluded that the SEC met the applicable relevant legal standard, *i.e.*, that "the Commission must have (1) examined 'the relevant data' and (2) articulated a 'satisfactory explanation' possessing a 'rational connection between the facts found and the choice made.'"¹⁰ More specifically, the Court found that—as required under the relevant standard—the SEC provided "good reasons" for the rescission of the 2020 Rules, and that "the agency believes [the reversal] to

⁵*Chamber of Commerce*, 2023 WL 3063819, at *16

⁶ *Id.* at *17 (emphasis added).

⁷ *Id.* at *15.

⁸*National Association of Manufacturers*, 2022 WL 17420760, at *1.

⁹ *Id.* at *8.

¹⁰ *Id.* at *4.

be better.”¹¹ According to the SEC, the rescission of the 2020 Rules was a better policy because: “First, the 2022 Rescission would ‘alleviate[] costs ... to PVABs’ imposed by the 2020 Amendments. Second, reversing the 2020 Amendments would better ‘address PVAB clients’ and other investors’ concerns about receiving timely and independent advice from PVABs.”¹² The Court granted the SEC’s motion for summary judgment.

Two Recent Decisions: Court Denies Summary Judgment

These two decisions demonstrate that any further challenges to the viability of the SEC’s rescission of the 2020 Rules will likely be unsuccessful. As such, investors should feel confident that their voting independence through the use of PVABs remains secure in future proxy-contests. As anticipated and discussed in the previous Labaton Sucharow [Investor Alert](#), moving forward, future proxy-battles will revert to pre-2020 dynamics in terms of the mechanics of proxy-voting – which is now further cemented by the courts upholding the SEC’s rescission of the 2020 Rules.

There also will likely be less exposure to potential litigation. One of the main concerns of the 2020 Rules, as articulated by the Council for Institutional Investors, was that this could “result in delays in distribution of proxy advice, driving up costs for investors, impairing the independence of proxy advice and causing uncertainty for institutional investors.”¹³ Particularly, under the old 2020 Rules, companies could disagree

with the PVABs’ methodology or recommendation which would drive increased exposure to litigation and increased costs or delay.

In sum, the courts’ upholding of the SEC’s 2022 rescission of the 2020 Rules—under direct challenges from different business-industry groups—further solidifies the following benefits to institutional investors who wish to use PVABs in any proxy dispute:

- ◆ Increased independence in voting decisions
- ◆ Less exposure to litigation by the company
- ◆ More certainty
- ◆ Less threat of drawing out the voting process and delay
- ◆ Lower costs to PVABs

The rationale and conclusions reached by the courts in *Chamber of Commerce of the United States of America et al. v. SEC*, No. 22-cv-00561, 2023 WL 3063819 (M.D. Tenn. Apr. 24, 2023) and *National Association of Manufacturers et al. v. SEC*, No. 22-cv-00163, 2022 WL 17420760 (W.D. Tex. Dec. 4, 2022) are therefore highly encouraging for both investors and the PVABs who service such investors.

¹¹*Id.* at *5.

¹²*Id.*

¹³https://www.cii.org/july22_sec_proxy_advice_rules

Labaton Sucharow's lawyers are available to address any questions you may have regarding these developments. Please contact the Labaton Sucharow lawyer with whom you usually work or the contacts below.

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