

CLIENT ALERT

Navigating Compensation Governance

Federal Court Vacates SEC's Scaled Back Rules Governing Proxy Voting Advice

Last month, a federal appeals court vacated the SEC's amendments adopted in 2022 that would have scaled back its regulation of proxy advisory firms (PAFs) (2022 Amendments).

The effect of the appeals court's ruling is to reinstate the requirement that a public company be provided an opportunity to review a PAF's report at or before the time it is sent to PAF clients.

However, the court's decision may not be the last word on the SEC's attempt to regulate PAFs. We expect this and another court ruling to be appealed.

Background

In 2019 and 2020, the SEC issued guidance and proposed and adopted rules that interpreted the definition of "solicit" and "solicitation" to include the provision of proxy voting advice (i.e., vote recommendations) by PAFs to their clients. As a result, PAFs became subject to regulation by the SEC and certain information and filing requirements typically applicable to public companies (2020 Rule).

The 2022 Amendments rescinded prior conditions a PAF must meet to be exempt from the proxy rules' information and filing requirements. Specially, PAFs no longer had to satisfy the following requirements:

- Proxy voting advice must be made available to a subject company at or before the time that the PAF makes the advice available to their clients.
- Company's written response to a PAF's proxy voting advice must be made available to PAF clients in a timely manner before the shareholders meeting (together "notice-and-awareness conditions").

Lawsuit Challenging SEC's 2022 Amendments

In 2022, National Association of Manufacturers and Natural Gas Services Group, Inc. filed suit against the SEC, alleging that the 2022 Amendments should be invalidated as arbitrary and capricious under the Administrative Procedure Act. The plaintiff organizations favored the notice-and-awareness conditions that were intended to facilitate engagement between proxy advisors and subject companies.

The district court rejected the plaintiffs' arguments and granted summary judgment in favor of the SEC.

Appeals Court Ruling

Last month, a federal appeals court reversed the district court decision and held that the SEC acted arbitrarily and capriciously in rescinding the notice-and-awareness conditions. The Court concluded that the SEC had done so in two ways: “First, the agency failed adequately to explain its decision to disregard its prior factual finding that the notice-and-awareness conditions posed little or no risk to the timeliness and independence of proxy voting advice. Second, the agency failed to provide a reasonable explanation why these risks were so significant under the 2020 Rule as to justify its rescission.”

As a result, the Court partially vacated the 2022 Amendments, effectively reinstated the notice-and-awareness conditions, and remanded the matter to the SEC for rulemaking consistent with the decision.

Meridian Comment: This is the second case challenging the SEC’s rules governing PAFs. In February 2024, a federal district court in the District of Columbia vacated the SEC’s 2020 Rule on the grounds that the SEC acted contrary to law and violated its statutory authority.

The current circumstances are messy and contradictory. One federal court has ruled the SEC lacked rulemaking authority in issuing rules governing PAFs, while another federal court has ruled that the SEC failed to adhere to statutory procedures in scaling back those rules. Both court decisions will likely be appealed. If the D.C. court ruling stands, then the SEC will not be able to regulate proxy advisory firms through the proxy solicitation rules. On the other hand, if the D.C. court ruling is overturned, but the Fifth Circuit ruling is upheld, then the SEC’s 2020 Rule will go into effect if the SEC decides to implement it.

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