

# INSIGHTS

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## CORPORATE GOVERNANCE

### Anticipating the First Wave of Proxy Access Shareholder Proposals

*The SEC's controversial mandatory proxy access rule was struck down by the U.S. Court of Appeals for the District of Columbia on July 22, 2011. However, the amendments to its shareholder proposal rule to permit proxy access shareholder proposals is now in effect. What can we expect to see this coming proxy season, and how will the Court's ruling impact other SEC (and other agencies') rulemaking?*

**By Keir Gumbs, Brandon Gay, Paula Domingos and Sara Needles**

As authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) on August 25, 2010, the U.S. Securities and Exchange Commission (SEC) adopted long-awaited "proxy access" rules, which would have required that public companies include in their proxy materials shareholder nominees to the board of directors under certain circumstances.<sup>1</sup> For many investors, this was a significant accomplishment—the SEC has grappled with the notion of giving shareholders the right to include nominees to the board in a company's proxy materials

since as early as 1942, and it was not until 2010 that the agency was able to successfully adopt rules facilitating this right.<sup>2</sup> This victory, however, was short lived, as Rule 14a-11, the centerpiece of the proxy access rules, was immediately challenged and vacated one year later in *Business Roundtable and Chamber of Commerce v. Securities and Exchange Commission*.<sup>3</sup> This decision not only impacts proxy access, but also will have a long-term impact on other SEC rulemaking, particularly that mandated by the Dodd-Frank Act.

### Proxy Access Rules Adopted and Challenged

#### Background

Rule 14a-11 would have required that a public company include in its proxy materials board nominees from a shareholder (or a shareholder group) who continuously owned at least 3 percent of the company's securities for three years. Under Rule 14a-11, a company would have been required to include in its proxy materials up to the number of nominees representing 25 percent of the company's board (but no fewer than one nominee).

To complement Rule 14a-11, the SEC also amended Rule 14a-8, the shareholder proposal rule, to provide that companies could no longer exclude proxy access shareholder proposals on the basis that such proposals relate to an election of directors.<sup>4</sup> To address concerns regarding

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the lack of information that otherwise would be available about a nominating shareholder, the SEC also adopted rules requiring certain disclosures by a nominating shareholder that are similar to those that would be required in a proxy contest.

All of these changes were slated to take effect in time for the 2011 proxy season. However, on October 4, 2010, the SEC granted a request from the U.S. Chamber of Commerce (Chamber) and the Business Roundtable (BRT) to stay the effectiveness of the proxy access rules pending a judicial review of a claim challenging their validity in the Court of Appeals for the District of Columbia. On July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit (D.C. Circuit) ruled in favor of the Chamber and the BRT, vacating Rule 14a-11, noting:

We agree with the petitioners and hold the Commission acted arbitrarily and capriciously for having failed once again—as it did most recently in *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166, 167–68 (D.C. Cir. 2010), and before that in *Chamber of Commerce*, 412 F.3d at 136—adequately to assess the economic effects of a new rule. We agree with the petitioners and hold the Commission acted arbitrarily and capriciously for having failed once again—as it did most recently in *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010), and before that in *Chamber of Commerce*, 412 F.3d at 136—adequately to assess the economic effects of a new rule.

On September 6, 2011, the SEC announced that it would not appeal the *Business Roundtable* decision, and it allowed its self-imposed stay of the effective date of the amendments to Rule 14a-8 and related rules to be lifted.<sup>5</sup> As a result, such other rules and rule amendments became effective on September 20, 2011.<sup>6</sup>

## **Proxy Access After *Business Roundtable***

### **Status of Rule 14a-8 Amendments**

Although Rule 14a-11 no longer exists, the Rule 14a-8 amendments left in place by the *Business Roundtable* decision remain a viable mechanism to achieve proxy access. Historically, the SEC has taken the position that shareholder proposals seeking to nominate persons to the board or create processes by which shareholders may nominate persons to the board are excludable under Rule 14a-8(i)(8) on the basis that such proposals relate to the election of directors.<sup>7</sup> Now, Rule 14a-8(i)(8) no longer provides a basis for excluding proxy access shareholder proposals solely on these grounds. Instead, such proposals are treated like any shareholder proposals that seek to establish election procedures, which proposals generally may not be excluded on the basis that they relate to the election of directors, but may be excludable under other bases set forth in Rule 14a-8.

### **Proxy Access Shareholder Proposals Under Consideration**

With the Rule 14a-8 amendments in place, investors and companies alike are speculating about whether the 2012 proxy season will be marked by a wave of proxy access shareholder proposals. It is difficult to determine with any certainty whether this will be the case. History does not provide a clear indication. For example, during the 2007 proxy season, the last time shareholders were allowed to submit such proposals, four companies received such proposals, and three of the proposals went to a vote.<sup>8</sup> The proposals earned 43 percent support at Hewlett-Packard, 45 percent approval at UnitedHealth Group, and 53 percent approval during a proxy fight at small-cap Cryo-Cell International.<sup>9</sup> However, whether these numbers are indicative of what to expect during the upcoming proxy season is anyone's guess.

Further, predictions by investor groups regarding whether they will submit proxy access shareholder

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proposals are decidedly mixed. The Executive Director of the Council of Institutional Investors has stated that she expects shareholders to be selective in filing proxy access shareholder proposals, most likely at companies where boards have been unresponsive to shareholder concerns.<sup>10</sup> Similarly, the director of corporate governance at CalSTRS has stated that the pension fund plans to file proxy access shareholder proposals under Rule 14a-8, although she did not give any details as to what companies CalSTRS is targeting, except that the fund would use the rule when a company and its board are not doing their jobs.<sup>11</sup> Retail investors are expected to submit proxy access proposals as well; some individual shareholder activists have already begun working on model proposals that call for low nomination eligibility requirements and full disclosure of election expenditures.<sup>12</sup>

Notwithstanding the foregoing levels of shareholder interest in proxy access, few commentators expect a flood of such proposals. Rather, some commenters have noted that if investors file a large number of access resolutions next year, corporate advocates will have a stronger case in arguing that federal access standards are not needed.<sup>13</sup> Thus, there is a great deal of uncertainty surrounding the extent to which shareholders will use Rule 14a-8 in the upcoming proxy season.

### **Potential Forms of Shareholder Access Proposals and Potential Arguments for Exclusion**

Like all shareholder proposals, a proxy access shareholder proposal may be submitted in one of two forms: as a “precatory” proposal that requests that the board take the actions requested by the proposal, or as a “mandatory bylaw” amendment, which if approved by shareholders at the threshold required by applicable state law, would immediately amend a company’s bylaws. We expect that the first wave of proxy access shareholder proposals will be submitted in the form of precatory proposals because: (1) a mandatory bylaw amendment must be crafted carefully to avoid providing a company with a

basis for exclusion under one of the state law-based bases for exclusion; and (2) a shareholder proposal may not exceed 500 words, thus limiting the space a proposing shareholder has to craft a proposal that fits under applicable state law and adequately explain how the proposal would work.

It bears noting that the minimum ownership thresholds included in Rule 14a-11 will have little importance under the current shareholder access regime. Rule 14a-8 imposes a low minimum ownership requirement, only \$2,000 of the relevant company’s securities, while a shareholder will be free to propose any minimum ownership threshold (or none at all) for shareholder nominations to the board. In light of the debate surrounding the minimum ownership requirements included in Rule 14a-11, we expect that proxy access shareholder proposals will propose thresholds significantly lower than the three percent for three years threshold included in Rule 14a-11. The proposals submitted to Hewlett-Packard, UnitedHealth Group, and Cry-Cell International, proposed minimum ownership periods ranging from three to five percent for two years. Based on comments submitted with respect to Rule 14a-11, we expect that large institutional investors will not support proxy access shareholder proposals that establish minimum ownership amounts below one percent of a company’s securities.

While proxy access shareholder proposals may be excludable on any number of bases under Rule 14a-8, prior no-action letters suggest that several of these bases have a higher likelihood of success than others, including the following:<sup>14</sup>

- ***Proposals that exceed the 500-word limitation (Rule 14a-8(d)).*** Proxy access shareholder proposals, particularly proposals in the form of mandatory bylaw amendments, will be challenged to comply with the 500-word limitation imposed by Rule 14a-8(d). This is due to the fact that a proxy access shareholder proposal must provide shareholders with an

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explanation of how the proposal would operate in order to avoid exclusion on the basis that a proposal is vague and indefinite.<sup>15</sup> We expect that this limitation will be particularly difficult with respect to proxy access shareholder proposals, which can raise complex issues under state law. In order to exclude a proposal on this basis, however, a company must notify a shareholder that the proposal exceeds 500 words and give the shareholder an opportunity to reduce the proposal to fewer than 500 words.<sup>16</sup>

- ***Proposals that concern improper subjects for shareholder action or would cause companies to violate applicable state law (Rules 14a-8(i)(1) and 14a-8(i)(2)).*** Proxy access shareholder proposals, particularly proposals in the form of mandatory bylaw amendments, are likely to be challenged on the basis that they do not comport with state law. While the SEC does not purport to be an expert on matters of state law, arguments for exclusion under Rules 14a-8(i)(1) and 14a-8(i)(2) have become more common, particularly as shareholders have increasingly pursued corporate governance reforms, such as majority voting, the right of shareholders to call special meetings, and the right of shareholders to act by written consent, all of which implicate applicable state law. However, in light of amendments to Delaware law in 2009 that clarified that companies and shareholders can adopt proxy access bylaws, these arguments may be less successful in Delaware than they might be in other jurisdictions.<sup>17</sup> Other arguments based on a company's governing instruments or applicable state law could provide viable bases for exclusion, but a company will have to meet its burden of demonstrating that the proposal violates state law, including by providing an opinion of counsel from a lawyer licensed to practice in the jurisdiction upon which the opinion is based.<sup>18</sup> In light of the SEC's lack of experience in these areas, proxy access shareholder proposals submitted to Delaware companies may lead to the certification of

questions regarding such proposals by the SEC to the Delaware Supreme Court.<sup>19</sup>

- ***Proposals that are materially vague and indefinite (Rule 14a-8(i)(3)).*** Proxy access shareholder proposals, particularly proposals in the form of mandatory bylaw amendments, are likely to be challenged on the basis that they violate Rule 14a-8(i)(3), which allows a company to exclude shareholder proposals that are materially vague and indefinite. As noted above, in order to avoid exclusion on this basis, a proxy access shareholder proposal must describe how the proposal would operate in practice. In some cases, the SEC has granted no-action relief on this basis with respect to bylaw amendments that were insufficiently described in the proposal and supporting statement or confusing in their application.<sup>20</sup> We expect that the complexity associated with proxy access shareholder proposals make this basis for exclusion particularly viable.
- ***Proposals that directly or indirectly seek to nominate a specific person to the board (Rule 14a-8(i)(8)).*** Notwithstanding the amendments to Rule 14a-8, a proxy access proposal that has the effect of nominating a specific person to the board of directors could still be excluded under Rule 14a-8(i)(8).<sup>21</sup> Accordingly, we expect companies to make creative arguments for exclusion on this basis to the extent that a proxy access shareholder proposal could be characterized as seeking to nominate a particular person or group of persons to the board.
- ***Proposals that conflict with company proxy access proposals (Rule 14a-8(i)(9)).*** While few companies will adopt proxy access procedures on their own in the near-term, Rule 14a-8(i)(9) may provide some incentive to do so. Under that basis for exclusion, a company that submits its own proxy access proposal to a shareholder vote may exclude proxy access shareholder proposals from its proxy materials. The SEC has indicated that, in order for this exclusion to be available, the proposals

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need not be “identical in scope or focus,” which means that a company-proposed proxy access bylaw could set minimum ownership and related standards that are more restrictive than a proposed proxy access shareholder proposal.<sup>22</sup> Of course, companies that are hesitant to submit to a proxy access regime may reject this strategy and instead adopt a wait-and-see approach.

- ***Proposals that have been substantially implemented (Rule 14a-8(i)(10)).*** A company that chooses to adopt a proxy access procedure also could argue that a proxy access shareholder proposal has been substantially implemented. To succeed on this basis, a company must demonstrate that its proxy access procedure compares favorably with the shareholder proposal.<sup>23</sup> In practice, however, a review of SEC no-action letters on the topic suggests that the standard applied by the staff requires that a company implement all of the material elements of a shareholder proposal to get no-action relief, making it very difficult for companies to obtain no-action relief on this basis.<sup>24</sup> As a result, the mere adoption of a proxy access procedure will not guarantee that the company will be able to exclude proxy access shareholder proposals from its proxy materials. Instead, a company will have to evaluate whether the structure of its proxy access procedure, such as the minimum ownership requirements, number of nominations that can be made, and related matters, are substantially similar to the proposal at issue (which is unlikely if the shareholder proposal seeks to establish a low minimum ownership threshold).<sup>25</sup>

As suggested above, companies and shareholders are entering into uncharted territory — none of the foregoing bases for exclusion have been considered by the staff of the SEC in the context of proxy access shareholder proposals. As a result, to the extent that proxy access shareholder proposals are submitted in connection with the 2012 proxy season, companies and shareholders

would be well advised to monitor staff no-action letters on these topics.

### **Company Actions in Anticipation of Proxy Access Shareholder Proposals**

Given the uncertainty associated with the number and nature of proxy access shareholder proposals that will be submitted this proxy season, companies should focus on issues within their control. Prudent steps would include engaging with shareholders to address issues before they result in the submission of, or support for, proxy access shareholder proposals, as well as identifying gaps relating to their director nomination procedures. This process also may include reviewing a variety of company documents, such as the company’s director qualification provisions, which may be included in a company’s bylaws, nominating/governance committee charter and corporate governance guidelines. Finally, companies should consider reviewing their advance notice bylaw provisions in light of potential proxy access shareholder proposals.

### ***Director Qualification Provisions***

As suggested above, a company may look to director qualification provisions in its governing instruments for an additional basis for excluding a proxy access shareholder proposal if the proposal includes conflicting qualification provisions. Before the adoption of the Dodd-Frank Act, companies rarely used director qualification provisions because they had the effect of limiting the pool of potential recruits from which management could select.<sup>26</sup> That may change now.

Delaware law is fairly permissive with respect to director qualification bylaw provisions.<sup>27</sup> The Delaware Court of Chancery has indicated that it would uphold reasonable director qualification bylaw provisions that are applied consistently and are not applied retroactively to prevent an otherwise-qualified nominee from being seated.<sup>28</sup> In fact, even the possibility that a

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director qualification provision could disenfranchise a shareholder may not be enough to invalidate an otherwise valid director qualification provision.<sup>29</sup> To strengthen the validity of director qualification bylaw provisions, companies could consider seeking shareholder approval of such provisions. A director qualification provision that is ratified by shareholder vote, whether in the context of an amendment to the charter or a shareholder approved bylaw, is afforded a greater level of legitimacy than a provision that is adopted without shareholder approval.<sup>30</sup>

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Based on the above, companies appear to have significant latitude with respect to crafting director qualification provisions. As a result, we expect companies to consider a variety of such qualifications, including, for example, provisions that disqualify from board service candidates who (1) do not own a sufficient amount of company stock, (2) do not satisfy minimum requirements for experience in the company's industry, (3) are executives at a company's competitor, (4) have been convicted of certain securities violations, or (5) possess comparably undesirable characteristics. Before moving forward with changes to director qualification provisions, however, a company should keep in mind that it will have to live with whatever director qualification provisions it adopts. In other words, a company should make sure that the standards it adopts are reasonable and would not preclude its board from nominating candidates to the board who otherwise may be in the company's best interests.

***Advance Notice Bylaw Provisions***

Most public companies have adopted "advance notice" provisions in their bylaws that require that

shareholders satisfy various conditions, including providing advance notice, in order to make nominations or propose other business from the floor of a company's annual meeting of stockholders.<sup>31</sup> Such provisions are designed to facilitate orderly meetings and to give a company time to evaluate and respond to shareholder proposals and nominations.<sup>32</sup> Delaware courts generally have upheld advance notice bylaw provisions unless it can be shown that such provisions were adopted or applied to entrench management or to disenfranchise shareholders.<sup>33</sup>

The amendments to Rule 14a-8 raise a number of questions with respect to the interaction between the rule and advance notice bylaw provisions. One such question relates to whether the failure to comply with the deadline imposed by an advance notice bylaw provision provides a basis for a company to exclude a Rule 14a-8 shareholder proposal.<sup>34</sup> In addition, questions have arisen regarding whether companies can employ such provisions to limit the types of proxy access shareholder proposals that may be submitted in reliance on Rule 14a-8. The staff's view of these issues and the thorny questions raised by the debate are illustrated by the staff's no-action response to a letter submitted by Dollar Tree Stores.<sup>35</sup> In that letter, the staff took the position that a shareholder's failure to notify a company of its intent to appear to present a proposal as required by the company's advance notice bylaw would not provide a basis for excluding a shareholder proposal. The staff has taken a similar position in comparable circumstances.<sup>36</sup>

Notably, Dollar Tree supported its no-action request by quoting an SEC release where the SEC asserted that the failure to observe procedural requirements enforceable under applicable state law constituted grounds for exclusion under the rule.<sup>37</sup> Specifically, the SEC has noted the following:

With respect to subjects and procedures for shareholder votes, most state corporation

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laws provide that a corporation's charter or bylaws can specify the types of proposals that are permitted to be brought before the shareholders for a vote at an annual or special meeting. Rule 14a-8(i)(1) supports these determinations by providing that a proposal that is not a proper subject for action by shareholders under the laws of the jurisdiction of the corporation's organization may be excluded from the corporation's proxy materials.<sup>38</sup>

Notwithstanding this language, the staff has not granted no-action relief on this basis. In fact, it appears from Dollar General and similar no-action responses that the staff is uncomfortable allowing companies to rely on procedural requirements in their bylaws to exclude otherwise valid Rule 14a-8 proposals.

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***The SEC will have to decide whether to abandon universal proxy access for the time-being***

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One way of reconciling the statement quoted above with the staff's position in Dollar General and other no-action letters may be to take the view that a company may not erect procedural hurdles to the submission of valid shareholder proposals, but that a company could circumscribe the subjects about which a shareholder can take action. For example, a company's bylaws might provide that a shareholder may not submit proxy access shareholder proposals, or provide that proxy access shareholder proposals that permit the nomination of more than a minority of board members are invalid.

We expect that the likelihood that companies will adopt such bylaw provisions in the near future is low, although some companies may consider adopting such provisions in response to the amendments to Rule 14a-8. The legal uncertainty associated with such provisions under state law,

the potentially negative shareholder relations implications of such provisions and the ambiguity regarding whether the staff would allow companies to exclude proxy access shareholder proposal based on such provisions, all make the adoption of such provisions fraught with peril.

## **Implications of *Business Roundtable* on SEC Rulemaking**

### **The Future of the Proxy Access**

At least in the near term, the SEC's announcement that it will not appeal the *Business Roundtable* decision removes some of the immediate uncertainty surrounding proxy access; as a result, "universal" proxy access is, for all intents and purposes, dead for the coming proxy season. In the next year, the SEC will have to decide whether to abandon universal proxy access for the time-being or attempt to adopt a new Rule 14a-11 or a substantially similar rule.<sup>39</sup> Abandoning the idea of universal proxy access would be a significant setback for the SEC and may be a difficult pill for the SEC and its staff to swallow. The SEC and its staff expended substantial time and resources in connection with the rulemaking, and various constituencies already are urging the SEC to issue new proxy access rules.<sup>40</sup> Given these facts, as well as Chairman Schapiro's recent reaffirmation of her support for the right of shareholders to nominate directors at company meetings, it is difficult to imagine that universal proxy access is dead for good.<sup>41</sup>

However, adopting a new Rule 14a-11 may not be easy for the SEC to accomplish. As noted above, the *Business Roundtable* decision, at its core, was about the level of economic analysis that the SEC must employ when considering the potential consequences of a rulemaking. Twice burned in connection with its assessment of the economic underpinnings of its rules—in the *Chamber of Commerce*<sup>42</sup> and *American Equity Life Insurance Company* cases—the SEC included in the adopting release for Rule 14a-11 a long and detailed economic analysis intended to address judicial

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concerns in that regard.<sup>43</sup> Notwithstanding these efforts, the SEC's analysis fell short in the view of the D.C. Circuit. Accordingly, in order to adopt a new Rule 14a-11, the SEC would need to bolster significantly its economic analysis. This prospect raises unique challenges for the agency.

Some observers have suggested that, as an agency flush with lawyers, the SEC is not well-suited to engage in the level of economic analysis required by the high bar set by the D.C. Circuit.<sup>44</sup> In light of this apparent institutional impediment, as well as the fact that the SEC is busy with the numerous outstanding Dodd-Frank Act rulemakings, the SEC would need to reallocate its resources in a way that would sacrifice its ability to complete its already full rulemaking agenda. Alternatively, it could rely on outside organizations to conduct the detailed economic analysis necessary to survive a judicial challenge. Given the already limited resources available to the SEC, it appears unlikely that the SEC would make this sacrifice in the near future, particularly since the amendments to Rule 14a-8 have opened the door for proxy access shareholder proposals.

### Implications for Future Rulemakings

Perhaps even more significant are the implications of the *Business Roundtable* decision as they relate to the ability of the SEC (and other agencies) to conduct future rulemakings, particularly those required by the Dodd-Frank Act. Judicial review of administrative agency action is governed by the Administrative Procedure Act, which states that rulemakings, are reviewed for arbitrariness and capriciousness.<sup>45</sup> In *Business Roundtable*, the D.C. Circuit subjected the SEC's adoption of the proxy access rule to an especially exacting level of judicial scrutiny. Often, an agency must justify its rulemaking process and decisions with detailed explanations, including with respect to the related comments, counterarguments, and alternative courses of action.<sup>46</sup> Federal courts intend the scope of this type of review to be "searching and careful," however "the ultimate

standard of review is a narrow one" and a "court is not empowered to substitute its judgment for that of the agency."<sup>47</sup> Moreover, even in the face of such review, courts often exercise greater deference to an agency's interpretation of facts within the agency's given area of expertise.<sup>48</sup> The SEC has an additional hurdle in this regard. As noted in the *Business Roundtable* decision, Section 3(f) of the Exchange Act, directs the SEC to consider whether a proposed rule will promote "efficiency, competition, and capital formation." Such mandate further elevates the importance of the SEC's underlying economic analysis in the context of future challenges.

Even by these demanding standards, the *Business Roundtable* court has been criticized as having gone out of its way to find fault with the SEC's reasoning in adopting Rule 14a-11.<sup>49</sup> For example, it has been pointed out that the D.C. Circuit appears to have made a normative judgment regarding the studies the SEC relied upon to approve Rule 14a-11:

... the Commission relied upon insufficient empirical data when it concluded that Rule 14a-11 will improve board performance and increase shareholder value by facilitating the election of dissident shareholder nominees....The Commission acknowledged the numerous studies submitted by commenters that reached the opposite result. Id. at 56,762/2 & n.924. One commenter, for example, submitted an empirical study showing that "when dissident directors win board seats, those firms underperform peers by 19 to 40 percent over the two years following the proxy contest.... The Commission completely discounted those studies "because of questions raised by subsequent studies, limitations acknowledged by the studies' authors, or [its] own concerns about the studies' methodology or scope." ... The Commission instead relied exclusively and heavily upon two relatively unpersuasive studies, one concerning the

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effect of “hybrid boards” (which include some dissident directors) and the other concerning the effect of proxy contests in general, upon shareholder value....”<sup>50</sup>

According to some observers, the viewpoint expressed in the above excerpt is extraordinary because the D.C. Circuit appears to have substituted its judgment for that of the SEC.<sup>51</sup> That the court was willing to do so portends myriad difficulties for the SEC (and other agencies) in enacting future rules, particularly those required by the Dodd-Frank Act. In effect, the *Business Roundtable* decision has provided litigants with a playbook for challenging contentious agency rulemakings. Indeed, as a result of the ruling, it has been noted that the SEC staff currently is revisiting its pending rulemakings to bolster its economic analysis.<sup>52</sup> Other rulemakings mandated by the Dodd-Frank Act, many of which are as politically unpopular as proxy access, may be vulnerable to the same type of challenge.<sup>53</sup>

In a larger sense, the D.C. Circuit’s criticisms of the process that led to the adoption of Rule 14a-11 may impose additional front-end costs on potential SEC rulemakings. Concerned that it could never satisfy the bar set by the court, the SEC might instead attempt to act through less visible methods, including informal adjudications or policy statements. Otherwise, the agency would be required to explain its reasoning in extreme detail, respond to every major comment in opposition to a proposed rule, and continually try to identify the issues upon which a reviewing court might focus—all of which may only serve to lengthen and complicate the rulemaking process.

## Conclusion

As noted above, the *Business Roundtable* decision will have important consequences for the 2012 proxy season and beyond. The immediate impact will be in the shareholder proposal world, where companies and shareholders may find

themselves in unfamiliar territory as proxy access shareholder proposals are crafted in response to the amendments to Rule 14a-8. Going forward, as was the case with majority voting and other governance proposals, the next few years will be a laboratory for experimentation as shareholders draft proposals to address the various potential challenges available under the shareholder proposal rule and the appropriate contours for proxy access. Similarly, companies will have to evaluate how to respond to such proposals, not only in the context of challenges for exclusion under Rule 14a-8, but also in terms of potential changes to their governance policies and procedures, bylaw provisions and director qualification standards. Our sense is that many in the business community strongly oppose proxy access and will resist any suggestion that they pre-emptively adopt proxy access bylaws, as has been the case with respect to majority voting proposals. More broadly, the SEC will have to figure out how to incorporate the lessons from the *Business Roundtable* decision into future rulemakings, including a potential re-adoption of a universal proxy access rule. Thus, for now, we expect the SEC to focus on the many Dodd-Frank and other rulemakings on its agenda.

## Notes

1. See Securities and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess., at 17-19 (1943) (testimony of Chairman Ganson Purcell).
2. See e.g., Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Division of Corporation Finance (Jul. 15, 2003); SEC Rel. No. 34-13482 (Apr. 28, 1977); see also SEC Rel. No. 34-13901 (Aug. 29, 1977); SEC Rel. No. 34-31326 (Oct. 16, 1992); Security Holder Director Nominations SEC Rel. No. 34-48626 (Oct. 14, 2003); SEC Rel. No. 34-56161 (Jul. 27, 2007); Shareholder Proposals, SEC Rel. No. 34-56160 (Jul. 27, 2007); SEC Rel. No. 33-9136 (Aug. 25, 2010) (the “Adopting Release”).
3. See *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).
4. See Rules 14a-18 and 14n-1(a).
5. PresS Release, Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation (Sept. 6, 2011), available at <http://www.sec.gov>

*news/press/2011/2011-179.htm*.

6. See SEC Rel. No. 33-9259 (Sept. 15, 2011). As a result, Rule 14a-8(i)(8) now provides that a shareholder proposal may be excluded under Rule 14a-8(i)(8) if the proposal (1) would disqualify a nominee who is standing for election; (2) would remove a director from office before his or her term expired; (3) questions the competence, business judgment, or character of one or more nominees or directors; (4) seeks to include a specific individual in the company's proxy materials for election to the board of directors; or (5) otherwise could affect the outcome of the upcoming election of directors. As noted above, in adopting Rule 14a-11, the SEC amended Rule 14a-8 and adopted a number of new rules, regulations and forms, as well as amendments to certain of its existing rules, regulations and forms. In particular, the SEC amended the following items: (1) Rule 13, (2) Rule 13a-11, (3) Rule 13d-1, (4) Rule 14a-2, (5) Rule 14a-4, (6) Rule 15d-11, (7) Schedule 14A, and (8) Schedule 13G. In the main, these changes were intended to facilitate the implementation of Rule 14a-11 across the federal securities laws. Yet, much like the amendments to Rule 14a-8, the court ruling vacating Rule 14a-11 did not affect these rules and rule amendments.

7. See, e.g., Amoco Corp., SEC No-Action Letter (Feb. 14, 1990) (excluding a proposal that shareholders representing over \$100,000 in market value be allowed to nominate directors).

8. These proxy access shareholder proposals were submitted following *American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006) where the Second Circuit held that American International Group could not exclude a proxy access shareholder proposal submitted by AFSCME from its proxy materials in reliance on Rule 14a-8(i)(8). In concluding that AIG could not exclude the proposal from its proxy materials, the court effectively invalidated the SEC's interpretive view that such proposals could be excluded in reliance on Rule 14a-8(i)(8). Following this decision, the SEC adopted amendments to Rule 14a-8(i)(8) to re-establish that proxy access shareholder proposals could be excluded from company proxy materials on the basis that they relate to the election of directors.

9. At Hewlett-Packard, AFSCME Employees Pension Plan's shareholder access by-law proposal would have required HP to include the name and other information regarding certain shareholder nominated candidates for director into the company's proxy statement. See Hewlett-Packard Company, SEC No-Action Letter (Jan. 22, 2007). At UnitedHealth Group, CalSTRS' proposal would have allowed shareholder nominees to be included for shareholder consideration along with management nominees in board elections. See CalSTRS Letter to Shareholders, May 9, 2007. Under these proposals, investors could nominate directors as long as they held more than 3 percent of the shares for at least two years. At Cryo-Cell International, the approved proposal allowed shareholders who have held more

than 5 percent of the share for at least two years to include within the Company's proxy statement either one, two, or three nominees, depending on board size. See Cryo-Cell International Proxy Statement, July 16, 2007.

10. Kristen Gribben, More Proxy Access Proposals May Lie Ahead, September 12, 2011 available at [http://www.agendaweek.com/cl245822/29862/more\\_proxy\\_access\\_proposals\\_ahead?referrer\\_module=issue](http://www.agendaweek.com/cl245822/29862/more_proxy_access_proposals_ahead?referrer_module=issue) *Headline*; see also Ted Allen, Will Proxy Access Appear on Corporate Ballots in 2012?, September 8, 2011 available at <http://blog.issgovernance.com/gov/2011/09/proxy-access-on-the-ballot-in-2012.html>.

11. Gribben, *supra*, note 10 ("CalSTRS says it plans to file proxy access proposals, though the fund declined to say when, how many and at what companies. 'We will use 14a-8 when a company has been falling down on the job and the board has been asleep and not paying attention to shareholder concerns,' says Anne Sheehan, director of corporate governance at CalSTRS.")

12. James McRitchie, Proxy Access: What Now, with the Ban to be Lifted?, September 7, 2011, available at <http://corp.gov.net/?p=8117>.

13. *Id.*

14. See Rule 14a-8(i). A company may exclude a shareholder proposal that is (1) improper under state law; (2) would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject; (3) is contrary to any of the proxy rules; (4) relates to a personal claim or grievance, is designed to result in a benefit to the shareholder, or furthers a personal interest; (5) relates to operations that account for less than five percent of company's business and is not otherwise significantly related to the company's business; (6) the company would lack the power or authority to implement; (7) relates to the company's ordinary business operations; (8) could affect the particular outcome of the upcoming election of directors (9) directly conflicts with one of the company's proposals; (10) has already been substantially implemented by the company; (11) substantially duplicates another proposal; (12) deals with substantially the same subject matter as another proposal received previously and the proposal did not garner specified levels of shareholder support; or (13) relates to specific amounts of cash or stock dividends.

15. See, e.g., Bristol Myers Squibb, Co., SEC No-Action Letter (Jan. 30, 2008) (permitting the exclusion of a proposal calling for amending the bylaws "in order that there is no restriction on the shareholder right to call a special meeting, compared to the standard allowed by applicable law").

16. See, e.g., Excal Enterprises, Inc., SEC No-Action Letter (Jul. 15, 1999) ("While it appears that the proponent may have exceeded the 500 word limitation in rule 14a-8(d), it appears that Excal did not request that the proponent reduce the proposal to cure these deficiencies as required by rule 14a-8(f).").

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17. Delaware General Corporation Law § 112 provides that the bylaws of a Delaware corporation may provide that, if the corporation solicits proxies with respect to an election of directors, the corporation may be required to include in its solicitation materials one or more individuals nominated by a stockholder in addition to the individuals nominated by the board of directors.
18. *See, e.g.,* Commonwealth Energy Corp, SEC No-Action Letter, (Nov. 15, 2002) (concluding that the company had not met its burden of establishing that a mandatory bylaw amendment relating to director compensation and indemnification concerned an improper subject for shareholder action under California law); Dominion Resources, SEC No-Action Letter (Jan. 25, 2004) (concluding that the company had not met its burden of establishing that a mandatory bylaw amendment that would have provided that “no officer of the corporation receive annual compensation in excess of the limits established by U.S. Internal Revenue Code without shareholder approval” was not a proper subject for shareholder action under Virginia law).
19. In response to a no-action request from CA Inc. regarding a shareholder-proposed bylaw amendment, the SEC availed itself of a certification process under Delaware law under which the SEC may certify questions of Delaware law to the Delaware Supreme Court. CA, Inc., SEC No-Action Letter (Jun. 27, 2008).
20. *See* The Boeing Corporation, SEC No-Action Letter (Feb. 10, 2004) (“There appears to be some basis for your view that Boeing may exclude the proposal under rule 14a-8(i)(3) as vague and indefinite because it fails to disclose to shareholders the definition of “independent director” that it seeks to have included in the bylaws.”); SunTrust Banks, Inc., SEC No-Action Letter (Jan. 6, 2011) (concluding that a proposal that would amend the bylaws to require that the chairman be an independent director, as defined in the proposal could be excluded under Rule 14a-8(i)(3), noting “[t]here appears to be some basis for your view that SunTrust may exclude the proposal under rule 14a-8(i)(3), as vague and indefinite. In this regard, we note that in explaining where new language would be inserted into the bylaws, the proposal refers to “the last sentence of Article IV section 1” but quotes a different sentence.”).
21. *See, e.g.,* Transmeta Corp., SEC No-Action Letter (June 25, 2008) (proposal sought to nominate two specifically named individuals); Alaska Air Group, Inc., SEC No-Action Letter (Mar. 15, 2004) (proposal that the board amend its bylaws to implement a policy to communicate with shareholders regarding “winning shareholder proposals,” including a procedure that would “appoint” proponents of those winning majority votes to the board excludable under rule 14a-8(i)(8) as relating to an election for membership on its board of directors); CNA Financial Corp., SEC No-Action Letter (Feb. 15, 1983) (“There appears to be some basis for your view that the second proposal may be omitted from the Company’s proxy material under Rule 14a-8(c)(8), which allows the exclusion of a proposal if it relates to an election to office. In the Division’s view, the proposal’s requirement that three non-management stockholders not presently serving on the Board be appointed to the Board relates to the election of specific individuals to the Company’s Board and thus is excludable under Rule 14a-8(c)(8)”); Consolidated Edison Co. of New York Inc., SEC No-Action Letter (Mar. 2, 1977) (stating that “the proposal is in effect a nomination of the proponent for election to the Board of Trustees of the Company”).
22. Southwestern Energy Company, SEC No-Action Letter (Feb. 28, 2011) (“There appears to be some basis for your view that Southwestern Energy may exclude the proposal under rule 14a-8(i)(9). You represent that matters to be voted on at the upcoming shareholders’ meeting include a proposal sponsored by Southwestern Energy to amend Southwestern Energy’s Bylaws to reduce the percentage of shareholder vote required to call a special meeting to 20 percent. You indicate that the proposal and the proposal sponsored by Southwestern Energy directly conflict and would present alternative and conflicting decisions. You also indicate that inclusion of both proposals in the proxy materials could present conflicting results to the company, such as in the event that a shareholder voted in favor of both proposals.”)
23. *See* Texaco, Inc., SEC No-Action Letter (Mar. 28, 1991) (agreeing, upon reconsideration, that Texaco had substantially implemented a proposal that requested it subscribe to the Valdez Principles).
24. General Dynamics Corporation, SEC No-Action Letter (Jan. 24, 2011) (“We are unable to concur in your view that General Dynamics may exclude the proposal under rule 14a-8(i)(10). We note that the proposal specifically seeks to allow shareholders to call a special meeting if they own, in the aggregate, 10 percent of the company’s outstanding common stock, whereas General Dynamics’ bylaw requires a special meeting to be called at the request of a group of shareholders only if the group owns, in the aggregate, at least 25 percent of General Dynamics’ outstanding voting stock. We are therefore unable to conclude that the bylaw adopted by General Dynamics substantially implements the proposal.”).
25. Edison International, SEC No-Action Letter (Dec. 23, 2010) (“There appears to be some basis for your view that Edison may exclude the proposal under rule 14a-8(i)(10). Based on the information you have presented, it appears that Edison’s amended bylaws compare favorably with the guidelines of the proposal and that Edison has, therefore, substantially implemented the proposal.”).
26. J.W. Verrett, *Defending Against Shareholder Proxy Access: Delaware’s Future Reviewing Company Defenses in the Era of Dodd-Frank 16*, George Mason Law & Economics Research Paper No. 10-37 (Aug. 8, 2010), available at <http://www.ssrn.com/abstract=1655482>.
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27. *DEL. CODE ANN. tit. 8 § 141(b)* (“The certificate of incorporation or bylaws may prescribe other qualifications for directors.”).
28. *Stroud v. Grace*, 606 A.2d 75, 93 (Del. Supr. 1992); *Kurz v. Holbrook*, 989 A.2d 140, 157 (Del. Ch. 2010) (*rev’d in part on other grounds*).
29. *Id.* (stating that trial court had no basis to invalidate the bylaw “upon some hypothetical abuse” and to “invoke some hypothetical risk of harm rather than an examination of the board’s proven and entirely proper conduct.”)
30. *Id.* at 94.
31. See generally 1-9 Delaware Corporation Law and Practice § 9.05 (2009).
32. See generally *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25, 41-43 (Del. Ch. 1998).
33. See generally 1-9 Delaware Corporation Law and Practice § 9.05 (2009).
34. To address this question, most company advance notice bylaw provisions distinguish between Rule 14a-8 proposals and proposals to be brought from the floor of an annual or special meeting.
35. Dollar Tree Stores Inc., SEC No-Action Letter (Mar. 7, 2008).
36. See ProLogis Trust, SEC No-Action Letter (Mar. 28, 2002) (rejecting argument that company could rely on Rule 14a-8(i)(1) to exclude from its proxy materials a shareowner proposal that was untimely under the advance notice provisions of company’s bylaws); Tyson Foods, Inc., SEC No-Action Letter (Dec. 8, 1999) (rejecting arguments under Rule 14a-8(i) to exclude proposal because such proposal failed to meet Tyson Foods’ advance notice provision).
37. SEC Rel. No. 34-56160 (Jul. 27, 2007).
38. SEC Rel. No. 34-56914 (Dec. 6, 2007).
39. In addition, the SEC potentially could use other regulatory means at its disposal to implement proxy access. For example, one commentator has suggested that the SEC could use the antifraud provisions to require public companies to disclose information about shareholder nominees. See J. Robert Brown, Shareholder Access and the Uneconomic Economic Analysis: *Business Roundtable v. SEC*, available at <http://www.theracetothetbottom.org/home/shareholder-access-and-the-uneconomic-economic-analysis-busi-2.html>.
40. See, e.g., CalPERS, Press Release, Investors Urge New Rule on Proxy Access (Sept. 13, 2011).
41. Press Release, Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation (Sep. 6, 2011), available at <http://www.sec.gov/news/press/2011/2011-179.htm>.
42. See *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).
43. See *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166 (D.C. Cir. 2010).
44. See J.W. Verret, The Curious Case of the Proxy Access Rule, (July 22, 2011) (“This decision brings to light a fundamental problem at the SEC. Speaking against my own interest as a securities lawyer, I think it is an agency with too many lawyers and not enough economists. The Federal Reserve and Federal Trade Commission are better regulators because they have teams of sharp economists to consider the effects of new rules. As Senator Shelby noted in a recent hearing, the SEC on the other hand has over a thousand lawyers and less than 25 economists. Today’s decision is one of the predictable results. So were similar decisions striking down rules on the same basis in *American Equity v. SEC* and in *Chamber of Commerce v. SEC.*”) available at <http://truthonthemarket.com/2011/07/22/the-curious-case-of-the-proxy-access-rule>.
45. See 5 U.S.C. § 706(2)(A).
46. See *Motor Vehicle Manufacturers Ass’n v. State Farm Mutual Auto Insurance Co.*, 463 U.S. 29, 47-51 (1983).
47. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 US 402, 416 (1971).
48. See, e.g., *Hüls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996).
49. Lawrence A. Hamermesh, Random Thoughts on Proxy Access and Judicial Review, available at <http://blogs.law.widener.edu/del-corp/2011/08/17/random-thoughts-on-proxy-access-and-judicial-review/>.
50. *Business Roundtable* at 1150-51 (D.C. Cir. 2011).
51. See Hamermesh, *supra*, note 49.
52. Sarah N. Lynch and Christopher Doering, Analysis: Bruised Regulators Brace for Dodd-Frank Court Fights, Reuters, available at <http://www.reuters.com/article/2011/08/04/us-financial-regulation-courts-idUSTRE7730K220110804>.
53. See Ben Protess, Court Ruling Offers Path to Challenge Dodd-Frank, DealBook, available at <http://dealbook.nytimes.com/2011/08/17/court-ruling-offers-path-to-challenge-dodd-frank/> (suggesting that the conflicts minerals rules, in particular, could be particularly vulnerable to future challenges).

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