

5-6-2016

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Recommended Citation

Nicole Jones, Shareholder Proposals, Director Elections, and Proxy Access: The History of the SEC's Impediments to Shareholder Franchise, 93 Denv. L. Rev. F. (2016), available at <https://www.denverlawreview.org/dlr-online-article/2016/5/6/shareholder-proposals-director-elections-and-proxy-access-th.html>

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SHAREHOLDER PROPOSALS, DIRECTOR ELECTIONS, AND PROXY ACCESS: THE HISTORY OF THE SEC'S IMPEDIMENTS TO SHAREHOLDER FRANCHISE

INTRODUCTION

The Securities Exchange Act of 1934 (Exchange Act) created the Securities and Exchange Commission (SEC or Commission) and assigned the agency the task of promoting the integrity in the markets by providing investors with material information.¹ Section 14(a), however, gave the Commission the authority to regulate proxies and enact rules “in the public interest” or “for the protection of investors”² injecting the agency into the corporate governance process.³

Rule 14a-8 permits shareholders to include proposals in the company’s proxy statement.⁴ This Rule contains a number of substantive grounds for exclusion, including proposals relating to the election of directors.⁵ The election exclusion has evolved to allow for the omission of proposals that specifically affect an upcoming election.⁶ Until 2010, the exclusion applied to proposals that would have allowed shareholders to include nominees in company proxy materials.⁷

This article argues the SEC has impeded shareholder franchise through the election exclusion under Rule 14a-8. Part I traces the administrative history of the exclusion and analyzes the SEC staff’s (the staff) interpretation. Part II discusses more recent developments regarding the

1. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a–pp (2012)); see Exchange Act Release No. 34-41, 1934 WL 28590, at 4 (Nov. 15, 1934); see also *Bus. Roundtable v. SEC*, 905 F.2d 406, 408 (D.C. Cir. 1990) (concluding “that the Exchange Act cannot be understood to include regulation of an issue that is so far beyond matters of disclosure (such as are regulated under § 14 of the Act), and of the management and practices of self-regulatory organizations, and that is concededly a part of corporate governance traditionally left to the states”). The agency’s first Commissioner stated that the SEC’s purpose was to protect the investor through supervision while serving as “partners of honest business.” See Exchange Release No. 34-41, *supra*.

2. Securities Exchange Act of 1934 § 14(a).

3. See J. Robert Brown, Jr., *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATH. U. L. REV. 45, 49–52 (2007) (discussing the Commission’s role in regulating corporate governance). “The provision was intended to remedy a number of abuses chronicled during the hearing process, including the use of proxies ‘by unscrupulous corporate officials seeking to retain control of the management by concealing and distorting facts’ and to obtain approval for ‘vast bonuses out of all proportion to what legitimate management would justify.’” *Id.* at 51 (quoting S. REP. NO. 73-1455, at 77 (1934); 78 CONG. REC. 7861 (1934)).

4. See 17 U.S.C. § 240.14a-8 (2012).

5. See Exchange Act Release No. 34-378, 1935 WL 29270, at 4 (Sept. 24, 1935).

6. See discussion *infra* Section I.B.

7. See discussion *infra* Parts I–II.

exclusion including changes to shareholder access to the nomination process. Part III considers the problems presented by the exclusion and proposes a narrower staff interpretation.

I. ADMINISTRATIVE HISTORY AND STAFF INTERPRETATION

The Commission adopted the first set of proxy rules shortly after the enactment of the Exchange Act.⁸ Amendments quickly followed “based on the experience of security holders, corporations and the Commission’s staff.”⁹ For the most part, the early rules required the distribution of certain specified information to shareholders whenever companies solicited proxies.¹⁰

A. The Election Exclusion

In 1942, the SEC proposed a rule that would permit shareholders to include proposals and board nominees in management’s proxy materials.¹¹ The proposal would have allowed management to limit the number of nominees “on some fair and equitable basis.”¹² Investors showed little interest in the right to submit nominees, and management strongly opposed shareholder access of any kind.¹³ As a result, shareholders did not receive

8. Exchange Act Release No. 34-378, *supra* note 5, at 1. Under Section 14(a) of the 34 Act, the proxy rules generally govern “the solicitation of proxies, consents and authorizations in respect of securities listed on a national securities exchange.” *Id.* at 3-4 (“‘Solicitation’ is defined to include any communication or request for a proxy, consent, or authorization, or the furnishing of any form of proxy, whether or not the form is in blank.”). The Commission adopted the rules “to assure that the security holder whose proxy or consent is solicited will be afforded adequate information as to the action proposed to be taken, and as to the source of the solicitation and the interest of the solicitor.” *Id.*

9. Exchange Act Release No. 34-1823, 1938 WL 33169, at 1 (Aug. 11, 1938) (expanding the information required to be disclosed and designating the rules as Regulation X-14).

10. The initial rules did not require proxy materials to be filed with the Commission prior to distribution, which resulted in numerous instances of noncompliance with the disclosure requirements. *See* Exchange Act Release No. 34-378, *supra* note 5; *see also* *Sec. & Exch. Comm’n Proxy Rules: Hearing on H.R. 1493, H.R. 1821, & H.R. 2019 Before the H. Comm. On Interstate & Foreign Commerce*, 78th Cong. 18 (1943) [hereinafter *1943 Hearings*] (testimony of Chairman Ganson Purcell). The Commission then took the view that proxy materials were misleading where management did not disclose shareholder proposals that it knew would be presented at the meeting and that it intended to vote against. *See 1943 Hearings, supra*, at 16, 188, 170; *see generally* Exchange Act Release No. 34-1823, *supra* note 9. Consequently, the Commission amended the rules to require, as it does now, filing of proxy materials with the SEC for inspection prior to solicitation. Exchange Act Release No. 34-2376, 1940 WL 7144, at 1 (Jan. 12, 1940). The 1940 amendments also required disclosure of information regarding the proposals, along with a space on the proxy for the shareholder to vote on the proposals. *Id.* at 3. But, the initial rules did not apply to “the election of directors or other officials.” Exchange Act Release No. 34-1823, *supra* note 9, at 3.

11. Duty to Furnish Proxy Statements, Securities Act Release No. 33-2887, Exchange Act Release No. 34-3347, Investment Company Act No. 417, 1942 WL 34864, at 1 (Dec. 18, 1942) (proposing amendments to the rules to require companies to include proposals of which they had been given reasonable notice by the security holder); *see also 1943 Hearings, supra* note 10, at 35 (“The proposed rules also require that minority stockholders be given an opportunity to nominate directors or auditors to be submitted to their fellow stockholders by means of proxy.”).

12. *See 1943 Hearings, supra* note 10, at 35 (allowing management to limit the number of nominees to “only twice as many nominees as there are directors”).

13. *See* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1163-64 (1993) (“The unfavorable public response to that proposal led to a staff interpretation that Rule 14a-8 did not permit shareholder proposals in support of a slate of challengers.”).

the right to use company proxy materials for their nominees.¹⁴ Six years later, the Commission further amended the rules to more broadly prohibit any proposal relating to “elections to office.”¹⁵ Shareholders, therefore, could include neither nominees nor proposals that affected the electoral process in company proxy materials.

Shareholders wishing to run a slate of nominees for the board of directors in opposition to management’s nominees were instead required to create their own proxy statement and card and pay the solicitation costs.¹⁶ Accordingly, the staff reasoned that proposals naming a specific individual as a nominee¹⁷ or seeking to implement bylaws allowing shareholder nominees to be included in company proxy materials “would more properly be dealt with through Rule 14a-11.” Therefore, companies could omit such proposals from their proxy materials under the election exclusion.¹⁸

B. Early Staff Interpretation

Shareholder proposals that related to director elections generally fit into three categories: those that inherently affected an upcoming election; those that could have affected an upcoming election but need not have

Concerns regarding the Commission’s authority to “change the proxy into a ballot” by allowing nominees to be listed on the proxy statement were raised, along with concerns over confusion regarding grounds for excluding shareholder nominees and possible shareholder confusion. *See 1943 Hearings, supra* note 10, at 157.

14. *See* Exchange Act Release No. 34-3347, *supra* note 11, at 7–12 (adopting Rule X-14A-7, but stating “matters to be acted upon pursuant to proxy . . . do[] not apply to elections to office”). Although the Commission did not provide any reasoning for its decision, the proposal was considered to be too controversial. *See* J. Robert Brown Jr., *The SEC, and Shareholder Access to the Board Room*, 2008 UTAH L. REV. 1339, 1346 (2008).

15. Notice of Proposal to Revise Proxy Rules, Exchange Act Release No. 34-3998, 1947 WL 25504, at 7 (Oct. 10, 1947) (requiring management to file with the Commission, if management believes the rule does not apply, “a copy of the proposal as received from the security holder, together with a statement of the reasons why the . . . provisions of the rule are deemed not to apply”); Adoption of Amendments to Proxy Rules, Exchange Release No. 34-4185, 1948 WL 28695, at 1 (Nov. 5, 1948) (stating Rule X-14A-8 “will permit the omission of a stockholder’s proposal in certain instances” and “is amended to provide that proposals so omitted need not be referred to in the form of proxy and that the proxy may confer discretionary authority with respect to such proposals”). Furthermore, Rule X-14A-4(d) provides “[n]o proxy shall confer authority (1) to vote for the election or any person to office for which a bona fide nominee is not named in the proxy statement.” *Id.* at 2.

16. 17 C.F.R. § 240.14a-11. “If there is a contest with respect to the election of directors, the requirements of Rule 14a-11 must be complied with.” Broker-Dealer Participation in Proxy Solicitations, Exchange Act Release No. 34-7208, 1964 WL 66932, at 2 (Jan. 7, 1964); *see* Proposed Amendments to Proxy Rules, Exchange Act Release No. 34-5265, 1955 WL 6436, at 3 (Dec. 14, 1955) (discussing the requirements of soliciting proxies in opposition to “any other person or group of persons with respect to the election or removal of directors at any annual or special meeting of security holders”).

17. *See, e.g.*, Chrysler Corp., SEC No-Action Letter, 1978 WL 13043, at 1 (Jan. 23, 1978) (proposing two specific individuals as candidates in the upcoming director election).

18. *See, e.g.*, CBS, Inc., SEC No-Action Letter, 1973 WL 9134, at 4 (Feb. 20, 1973) (permitting exclusion of a proposal requiring the company’s bylaws to “be amended to provide that any shareholder attending an annual shareholder meeting who is nominated for Director of the Corporation at that meeting, shall be considered to be a potential candidate for Director for inclusion in the following year’s proxy material”).

been drafted to have such effect; and those that affected the electoral process more generally.¹⁹ The staff typically allowed for the exclusion of proposals that would result in contested elections. This included proposals that attempted to dissuade shareholders from voting in favor of management's nominees²⁰ or that named a specific individual as a nominee for election.²¹ For example, a proposal that would censure all of a company's directors could be excluded from the company's proxy materials.²² Because shareholders could not vote for both the censure and the re-election of the censured directors, the proposal effectively attempted to dissuade shareholders from voting for management's nominees, thereby resulting in a contested election.²³

In addition, the staff allowed for the exclusion of proposals that would affect upcoming elections to the board.²⁴ Some did so directly, for example, by calling for a director's resignation.²⁵ Others, however, depended upon how they were drafted. To the extent applicable immediately, proposals could be excluded in a variety of circumstances including where they set a specific mandatory retirement age,²⁶ required directors to own a certain number of shares,²⁷ or established certain qualifications regarding the composition of the board, such as a majority of the board be comprised of non-employee directors.²⁸ To the extent not applicable immediately, the

19. See *infra* notes 24–31 and accompanying text.

20. See, e.g., Denver Real Estate Inv. Ass'n, SEC No-Action Letter, 1973 WL 9151, at 4 (Mar. 6, 1973) (determining that a proposal, if implemented, "would disqualify trustees named in the supporting statement whom the management intends to nominate for re-election," and would dissuade shareholders from voting in favor of management's nominees).

21. See, e.g., Pan Am. World Airways, Inc., SEC No-Action Letter, 1975 WL 9934, at 4 (Apr. 18, 1975) (proposing Robert Paul Mangieri for a member of the Board of Directors"); see also *supra* notes 17–18 and accompanying text.

22. In re Union Elec. Co., 38 SEC 921, 0059 WL 59227, at 2 (Mar. 26, 1959).

23. See *id.* The Division argued that "the proposal would constitute a solicitation in opposition to the election of directors within the meaning of Rule[] . . . 14a–11" and that "such a proposal could be made only after the filing by [the proponent] of the statements required by Rule 14a–11 in election contests." *Id.* at 2.

24. The Division of Corporate Finance staff considers and responds to company's requests for "no-action." The Division issues no-action letters "to aid those who must comply with [] requirements [under the proxy rules] by offering informal advice and suggestions and to determine, initially, whether it may be appropriate in a particular matter to recommend enforcement action to the Commission." See, e.g., United Banks of Colo., Inc., SEC No-Action Letter, 1973 WL 9167, at 15 (Mar. 13, 1973).

25. See, e.g., Philipsborn, Inc., SEC No-Action Letter, 1974 WL 8295, at 7 (Jan. 24, 1974) (proposing "[t]hat Mr. Schwartz be requested to resign and that he by [sic] publically condemned for his poor management").

26. See, e.g., United Banks of Colo., Inc., *supra* note 24, at 10–11 (proposing "that the Board of Directors take those steps necessary to provide that all Directors retire at age 72").

27. See, e.g., Ariz. Pub. Serv. Co., SEC No-Action Letter, 1973 WL 9146, at 3 (Mar. 1, 1973) (proposing that "(a) Any candidate nominated by management for election to the Board of Directors must hold of record not less than 1000 shares of the common stock of this corporation[; and] (b) No Director shall continue in office unless such Director shall own of record not less than 1000 shares of the common stock of this corporation").

28. See, e.g., Exxon Corp., SEC No-Action Letter, 1975 WL 9867, at 8 (Feb. 18, 1975) (proposing that the "Board of Directors consist of a majority of non-employee directors").

staff typically did not permit exclusion. Moreover, the staff allowed shareholders to revise proposals to clarify that they did not apply to an impending election.²⁹

Finally, companies could not exclude proposals regarding the electoral process that did not inherently affect an upcoming election. For instance, the staff permitted the inclusion of proposals seeking cumulative voting in director elections, which purportedly “increase[d] the opportunity for minority representation,”³⁰ as well as proposals that fixed the number of directors on the board.³¹ Thus, the election exclusion did not completely silence shareholders so long as their proposals recognized the distinction between those affecting directors and nominees in forthcoming elections and those applying to future board members or more generally to the electoral process.³²

C. The 1976 Amendment and its Progeny

The language of the exclusion changed little through the late 1990s. The SEC proposed to amend the election exclusion in 1976 to permit omission of a proposal “if it ‘relate[d] to a corporate, political or other election to office.’”³³ Out of concern expressed by some that the provision would apply to proposals not previously excludable including “cumulative voting rights, general qualifications for directors, and political contributions by

29. See, e.g., First Mortg. Inv’rs, SEC No-Action Letter, 1973 WL 9194, at 4 (Apr. 23, 1973) (allowing prompt revision of a proposal requesting an amendment to the by-laws “whereby no office or Director or Trustee of F.M.A.C. may serve as a Trustee of First Mortgage Investors,” so “that it expressly states that it will not be applicable to those persons nominated by the management for election at the forthcoming annual meeting”).

30. See Ideal Basic Indus., Inc., SEC No-Action Letter, 1973 WL 9161, at 8–9 (Mar. 15, 1973) (discussing the previous inclusion of a cumulative voting proposal, as permitted in the corporation’s bylaws, with no reliance on the election exclusion to omit such proposal from management’s proxy materials); see also Kennecott Copper Corp., SEC No-Action Letter, 1975 WL 9893, at 2 (Mar. 6, 1975) (discussing an Advisory Opinion of the Commission in which it opined that cumulative voting was a “fair and equitable” voting method).

31. See, e.g., Mortg. Inv’rs of Wash., SEC No-Action Letter, 1977 WL 10503, at 8 (June 28, 1977) (finding the proposal could not be excluded for relating to director elections since “the proposal merely requests that the Trustees exercise the authority provided them by MIW’s Declaration of Trust to set the number of Trustees”).

32. If a shareholder’s proposals would affect the eligibility of a nominee or disqualify a current director from continuing to serve, revising the proposal to apply to future elections would remedy the impact on the current nominees’ eligibility, but would allow such qualifications to apply to directors in subsequent elections. Likewise, proposals affecting board composition, such as setting a single class of directors or the minimum number of directors, could affect the eligibility of a nominee or disqualify a current director. See, e.g., W. Pub. Co., SEC No-Action Letter, 1977 WL 13770, at 4 (Feb. 10, 1977). Thus, revising the proposal so as not to apply to the upcoming election was allowed. *Id.* at 5.

33. Adoption of Amendments Relating to Proposals by Sec. Holders, Exchange Act Release No. 34-12999, 1976 WL 160347, at 12 (Nov. 22, 1976). It appeared that the SEC was attempting to expand the scope of the election exclusion to cover political elections as it stated that the proposed amendment was also intended “to make clear that the proposed subparagraph would apply to a proposal relating to any type of election to office.” Proposed Amendments to Rule 14a-8 Under the Sec. Exch. Act of 1934 Relating to Proposals by Sec. Holders, Exchange Act Release No. 34-12598, Investment Company Act Release No. 9343, 1976 WL 160410, at 9 (July 7, 1976).

the issuer,” the final rule dropped the proposed addition.³⁴ Instead, the Commission, in addition to renumbering the Rule,³⁵ clarified the staff’s interpretation “to make clear, with respect to corporate elections, that Rule 14a-8 [was] not the proper means for conducting campaigns or effecting reforms in elections of that nature.”³⁶ Commission hearings regarding proxy rule reforms held later in the decade³⁷ also resulted in no significant changes to the election exclusion.³⁸

The Commission again reviewed the proxy rules in 1990.³⁹ The SEC proposed a universal ballot that would have allowed for competing slates of candidates, but the proposal was not adopted.⁴⁰ Through the 1990s, the

34. Exchange Act Release No. 34-12999, *supra* note 33, at 12. Instead, the provision would “read substantially as its predecessor under the former rule.” *Id.*

35. *Id.* at 1.

36. Exchange Act Release No. 34-12598, *supra* note 33, at 9. The SEC stated its attempt to clarify the substantive bases for omission of shareholder proposals in its Release regarding proposed amendments to Rule 14a-8, which were to be codified as 17 C.F.R. § 240.14a-8(c). *Id.* The staff further proposed several additional grounds for omission, but stated they “reasonably may have been implied from the existing rule.” *Id.* at 1, 5, 9; Exchange Act Release No. 34-12999, *supra* note 33, at 1.

37. See S’holder Commcn’s, S’holder Participation in the Corp. Electoral Process & Corp. Governance Generally, Exchange Act Release No. 34-14970, 1978 WL 196325, at 3–5 (July 18, 1978). Growing concerns over the proxy rules led to a comprehensive review by an SEC task force in 1977, in which the election exclusion was one of the main issues slated for examination. Re-Examination of Rules Relating to S’holder Commcn’s, S’holder Participation in the Corp. Electoral Process & Corp. Governance Generally, Exchange Act Release No. 34-13482, Investment Company Release No. 9740, 1977 WL 173444, at 1–2 (Apr. 28, 1977). In support of the review, the Commission recognized that public attention on corporate accountability arose after “a wide variety of questionable and illegal corporate practices” were made public. *Id.* at 2.

38. The Commission considered allowing shareholder nominees to be included in company proxy materials. See Brown, *supra* note 14, at 1358–59 (discussing the hearings). Based primarily on corporate management’s testimony, however, the Commission reported that the emergence of nominating committees rendered a shareholder nomination rule unnecessary. Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 441 (2012). The Commission instead required disclosures regarding nominating committees, and the election exclusion remained unchanged. Regulation of S’holder Commc’ns & Participation in the Corp. Electoral Process, Exchange Act Release No. 15,384, Investment Company Act Release No. 10,510, 16 SEC Docket 348, at 355 (Dec. 6, 1978); see Brown, *supra* note 14, at 1358–59.

39. See Regulation of Commc’ns Among S’holders, Exchange Act Release No. 31,326, 57 Fed. Reg. 48,276-01, 48,279 (Oct. 22, 1992) (to be codified at 17 C.F.R. pts. 240, 249).

40. See *id.*

staff continued to permit the exclusion of proposals addressing forthcoming elections.⁴¹ The staff, however, did not allow for the exclusion of proposals requesting bylaw amendments establishing general nominating procedures,⁴² director qualifications,⁴³ or majority voting requirements.⁴⁴

D. The 1998 Amendments

The SEC amended the election exclusion in 1998⁴⁵ with the intent “to reflect the current interpretation that the [R]ule only applies to proposals on elections of individuals for membership to, and removal from, the board of directors.”⁴⁶ The Commission also clarified that the exclusion applied to other governing bodies and not simply bodies holding the title of board of directors.⁴⁷

In a legal bulletin, the staff subsequently confirmed that shareholders could revise proposals to apply specifically to future elections where a

41. See, e.g., Alpha Indus., SEC No-Action Letter, 1987 WL 108232, at 2 (June 29, 1987) (proposing that all directors be elected annually). The staff permitted revision so that the proposal would not be applicable to the forthcoming election and would not disqualify current directors from finishing their terms. *Id.* at 1. Additionally, the staff distinguished between proposals seeking proxy access bylaws and those implementing more general nominating procedures. See, e.g., Unicare Servs., Inc., SEC No-Action Letter, 1980 WL 15475, at 2 (May 13, 1980) (proposing that the board “provide a means for any three stockholders to propose a candidate for the board of directors to be included in the management proxy solicitation to be voted on”). The staff did not agree that the proposal could be excluded on the basis of Rule 14a-8(c)(8) because it did “not relate to the election of directors at a particular meeting, but rather to the procedure to be followed to select nominees in general.” *Id.* The staff took the view that such forward-looking proposals “would not affect those directors elected” at the forthcoming meeting. *Id.*

42. See, e.g., TCW/DW Term Trust, SEC No-Action Letter, 1997 WL 398791 (July 15, 1997) (finding that a proposal mandating “an amendment to the Declaration of Trust to permit shareholders to nominate ‘independent’ trustees” related to the “procedures for election of directors” and could not properly be excluded under the election exclusion).

43. See, e.g., Am. Brands, Inc., SEC No-Action Letter, 1994 WL 4491 (Jan. 6, 1994) (finding a proposal that requested “directors and executive officers be required to own a minimum number of the Company’s securities” related “to the qualifications of directors and procedures for their election” and could not properly be excluded under election exclusion).

44. See Cinergy Corp., SEC No-Action Letter, 2005 WL 448205 (Feb. 18, 2005); see also JPMorgan Chase & Co., SEC No-Action Letter, 2005 WL 433465 (Feb. 22, 2005); Delta Air Lines, Inc., SEC No-Action Letter, 2005 WL 433469 (Feb. 22, 2005); Wal-Mart Stores, Inc., SEC No-Action Letter, 2005 WL 433464 (Feb. 22, 2005); Ecolab Inc., SEC No-Action Letter, 2005 WL 544217 (Feb. 22, 2005); El Paso Corp., SEC No-Action Letter, 2005 WL 484396 (Feb. 22, 2005); Am. Int’l Grp., Inc., SEC No-Action Letter, 2005 WL 596962 (Mar. 14, 2005).

45. See Amendments to Rules on S’holder Proposals, Exchange Act Release No. 34-40018, Investment Company Release No. 23200, 1998 WL 254809 (May 21, 1998). The amendments came about in response to a congressionally mandated “comprehensive study of the shareholder proposal process.” Amendments to Rules on S’holder Proposals, Exchange Act Release No. 34-39093, Investment Company Release Act No. 22828, 1997 WL 578696, at 3 (Sept. 18, 1997).

46. *Id.* at 7. The Commission also proposed that Rule 14a-8 be recast into a question and answer format to ease understanding for both shareholders and companies. *Id.* at 1.

47. Exchange Act Release No. 34-40018, *supra* note 45, at 3 (accounting for non-corporate entities with governing bodies titled something other than “board of directors” by stating the rule explicitly refers to elections to analogous governing bodies). The Commission adopted the slight change in language based on the staff’s previous application of the exclusion and one commenter’s suggestion. See *id.* Additionally, the amendments of exclusionary provisions were codified under 17 C.F.R. § 240.14a-8(i). See *id.* at 1.

proposal would disqualify directors from completing their terms or disqualify management's nominees at the upcoming shareholder meeting.⁴⁸ Rather than making substantive changes to the election exclusion, the Commission sought to ease understanding by recasting the Rule into a question and answer format and by reiterating the staff's interpretation that a shareholder proposal could be excluded from company proxy materials if it inherently or directly impacted an upcoming election.⁴⁹

II. RECENT DEVELOPMENTS

By the new millennium, institutional investors⁵⁰ increasingly sought greater access to the nomination process.⁵¹ With respect to proposals seeking the inclusion of shareholder nominees in the company's proxy statement, the staff consistently allowed for exclusion agreeing that such proposals would result in contested elections rather than merely establish general nomination procedures.⁵²

A. Shareholder Pressure and Access to the Proxy Statement for Nominees

Pressure built on the SEC to allow long-term investors greater access to the nomination process. Specifically, shareholders urged the SEC to allow for the inclusion of proposals that provided for shareholder access to the proxy materials.⁵³ In response to a campaign launched by the American Federation of State, County and Municipal Employees (AFSCME),⁵⁴ the

48. See Staff Legal Bulletin No. 14, SEC Release No. SLB-14, 2001 WL 34886112, at 15 (July 13, 2001).

49. See Exchange Act Release No. 34-40018, *supra* note 45, at 2-3, 27.

50. See D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 *FORDHAM L. REV.* 125, 131 (2011); see also Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 *YALE J. ON REG.* 174, 175-76 (2001) (discussing the rise of institutional investor activism from the early 1980s through the 1990s). Another change was taking affect as proposals were gaining approval at drastically higher levels than ever before. Jayne W. Barnard, *Shareholder Access to the Proxy Revisited*, 40 *CATH. U. L. REV.* 37, 74 (1990) (noting that "[i]n the 1990 proxy season, more shareholder proposals passed than in the preceding 40 years combined"). The staff "assumed that access proposals, like most shareholder proposals, would not command substantial shareholder support and could not win against management opposition. This assumption, however, was beginning to prove unsupportable." *Id.*

51. See, e.g., Bank of Bos., SEC No-Action Letter, 1990 WL 285947 (Jan. 26, 1990) (proposing that shareholders "may make one or more 'opposition' Director Nomination" that "shall appear in Proxy Materials same as the Board's Director Nominees").

52. See, e.g., *id.* (permitting exclusion and reasoning that the proposal "rather than establishing procedures for nomination or qualification generally, would establish a procedure that why [sic] result in contested elections to the board which is a matter more appropriately addressed under rule 14a-11").

53. In re Sec. Holder Dir. Nominations, Exchange Act Release No 34-48626, Investment Company Release No. 26206, 2003 WL 22350515, at 1 (Oct. 14, 2003) ("proposing new rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director," after "commentators urged the Commission to adopt rules that would provide security holders with greater access to the nomination process").

54. See Citigroup, Inc., SEC No-Action Letter, 2003 WL 1900802, at 1 (Apr. 24, 2003); Eastman Kodak Co., SEC No-Action Letter, 2003 WL 942718, at 1 (Feb. 28, 2003); Sears, Roebuck & Co., SEC No-Action Letter, 2003 WL 942680, at 1 (Feb. 28, 2003).

staff proposed a rule that would give shareholders a complicated and limited right of access to company proxy materials.⁵⁵ Not surprisingly, the proposal proved controversial and was never adopted.⁵⁶

In 2005, AFSCME submitted an access proposal to American International Group, and the staff predictably allowed exclusion.⁵⁷ This time, however, AFSCME sought relief in the federal courts. After losing at the trial level, the United States Court of Appeals for the Second Circuit reversed⁵⁸ and held that the election exclusion applied to proposals that related to a particular election not to those seeking to adopt shareholder access bylaws and other procedural rules affecting the electoral process.⁵⁹

The Second Circuit's decision represented the views of only one court. The staff refused to take a stance on the reasoning of the decision and simply declined to take any view with respect to no-action letters relating to access proposals.⁶⁰ As a result, some access proposals were submitted to shareholders through company proxy materials and received significant support with one obtaining approval of almost 60% of the votes cast.⁶¹ The Commission eventually proposed changes that would clarify the application of the election exclusion to access proposals.⁶² One would have reaffirmed the traditional staff interpretation that allowed companies

55. Exchange Act Release No 34-48626, *supra* note 53, at 2-3, 5 (Oct. 14, 2003). Shareholders would have been allowed access if 35% of the vote was withheld against a management nominated candidate, or if shareholders adopted a bylaw that required proxy access. *Id.* at 10. The bylaw proposal would have to have been submitted by a shareholder holding at least 1% of the issuer's voting stock. *Id.* at 11. In the event that such a bylaw was approved, or the requisite withhold occurred, only those shareholders owning at least 5% of the outstanding shares for at least two years could submit nominees. *Id.* at 13.

56. See *Brown*, *supra* note 14, at 1362. Instead, the Commission opted for expanded required disclosures by nominating committees. See Disclosure Regarding Nominating Comm. Functions & Comm'n's Between Sec. Holders & Boards of Dirs., Securities Act Release No. 33-8340, Exchange Act Release No. 34-48825, Investment Company Act Release No. 26262, 2003 WL 22794459 (Nov. 24, 2003) (to be codified at 17 C.F.R. pts. 228, 229, 240, 249, 270, 274) ("Specifically, we are adopting enhancements to existing disclosure requirements regarding the operations of board nominating committees and a new disclosure requirement concerning the means, if any, by which security holders may communicate with directors.").

57. See Am. Int'l Grp., Inc., SEC No-Action Letter, 2005 WL 372266, at 1 (Feb. 14, 2005).

58. See *AFSCME v. Am. Int'l Grp., Inc.*, 361 F. Supp. 2d 344, 347 (S.D.N.Y. 2005), *rev'd*, 462 F.3d 121, 131 (2d Cir. 2006).

59. *AFSCME v. Am. Int'l Grp., Inc.*, 462 F.3d 121, 129-30 (2d Cir. 2006).

60. See, e.g., *Hewlett-Packard*, SEC No-Action Letter, 2007 WL 224970, at 1 (Jan. 22, 2007) (expressing no view regarding whether HP could exclude the proposal under the election exclusion).

61. See *Brown*, *supra* note 14, at 1369.

62. Compare S'holder Proposals, Exchange Act Release No. 34-56160, Investment Company Act Release No. 27913, 2007 WL 2175940, at 7 (July 27, 2007), with S'holder Proposals Relating to the Election of Dirs., Exchange Act Release No. 34-56161, Investment Company Act Release No. 27914, 2007 WL 2175941, at 4 (July 27, 2007).

to exclude the proposals,⁶³ the other would have allowed shareholder access but in limited and restricted circumstances.⁶⁴

Rather than adopt either provision, the Commission opted to issue an interpretation that effectively overturned the Second Circuit's decision.⁶⁵ The Commission announced that the election exclusion would apply to shareholder proposals that sought proxy access including those that would provide nominating procedures.⁶⁶ To support its position, the Commission reasoned that such proposals would result in contested elections and would permit circumvention of the "other proxy rules designed to assure the integrity of director elections."⁶⁷

B. Proxy Access and the 2010 Amendments

Following a change in administration and one of the "most serious economic crises of the past century,"⁶⁸ the Commission in 2010 proposed both a rule that would allow shareholders to have access to the company's proxy statement for their nominees⁶⁹ and amendments to the election exclusion.⁷⁰ Following two public comment periods⁷¹ and the adoption of

63. See Exchange Act Release No. 34-56161, *supra* note 62, at 4 ("The proper functioning of the election exclusion is critical to prevent the circumvention of other proxy rules that are carefully crafted to ensure that investors receive adequate disclosure in election contests. Because the board of directors of a company most often will include its own director nominees in its proxy materials, allowing shareholders to include their nominees in company proxy materials would create what is, in fact, a contested election of directors, without the shareholders conducting a separate proxy solicitation.").

64. See Exchange Act Release No. 34-56160, *supra* note 62, at 7-9.

65. See S'holder Proposals Relating to the Election of Dirs., Exchange Act Release No. 34-56914, Investment Company Act Release No. 28075, 2007 WL 4442610 (Dec. 6, 2007) (to be codified at 17 C.F.R. pt. 240).

66. See *id.*; see also Eastman Kodak Co., SEC No-Action Letter, 2003 WL 942718 (Feb. 28, 2003); Sears, Roebuck & Co., SEC No-Action Letter, 2003 WL 942680 (Feb. 28, 2003); AOL Time Warner Inc., SEC No-Action Letter, 2003 WL 942784 (Feb. 28, 2003); The Bank of N.Y. Co., SEC No-Action Letter, 2003 WL 942997 (Feb. 28, 2003); ExxonMobile Corp., SEC No-Action Letter, 942753 (Feb. 28, 2003); Verizon Corp., SEC No-Action Letter, 2004 WL 5354462 (Jan. 28, 2004); Ford Motor Co., SEC No-Action Letter, 2004 WL 257704 (Feb. 6, 2004); Tenet Healthcare Corp., SEC No-Action Letter, 2004 WL 892270 (Mar. 15, 2004); Qwest Commc'ns Int'l Inc., SEC No-Action Letter, 2004 WL 584604 (Mar. 22, 2004); Am. Int'l Grp., Inc., SEC No-Action Letter, 2005 WL 372266 (Feb. 14, 2005).

67. Exchange Act Release No. 34-56914, *supra* note 65. The staff also expressed concerns about the use of a company's proxy statement without being subject to the antifraud provisions of the Exchange Act Rule 14a-9. See *id.* ("Additionally, false and misleading disclosure in connection with such an election contest could potentially occur without liability under Exchange Act Rule 14a-9 for material misrepresentations made in a proxy solicitation.").

68. Facilitating S'holder Dir. Nominations, Securities Act Release No. 33-9046, Exchange Act Release No. 34-60089, Investment Company Act Release No. 28765, 74, 2009 WL 1953653, at 3 (June 10, 2009) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249, 274).

69. See *id.* at 1 (proposing Rule 14a-11, which "would require, under certain circumstances, a company to include in the company's proxy materials a shareholder's, or group of shareholders', nominees for director").

70. See *id.* at 4 ("These proposed amendments are intended to remove impediments so shareholders may more effectively exercise their rights under state law to nominate and elect directors at meetings of shareholders.").

71. See Comments on Proposed Rule: Facilitating S'holder Dir. Nominations, U.S. SEC. & EXCH. COMM'N (Nov. 1, 2010), <http://www.sec.gov/comments/s7-10-09/s71009.shtml>.

Dodd-Frank,⁷² the Commission approved a rule requiring companies to provide 3% shareholders (individually or collectively) with access to the proxy materials for their nominees and significant revisions to the election exclusion.⁷³

The amendment significantly tightened the language⁷⁴ of the election exclusion by specifying the types of proposals that could be excluded.⁷⁵ These included proposals that:

- (i) Would disqualify a nominee who is standing for election; (ii) [w]ould remove a director from office before his or her term expired; (iii) [q]uestions the competence, business judgment, or character of one or more nominees or directors; (iv) [s]eeks to include a specific individual in the company's proxy materials for election to the board of directors; or (v) [o]therwise could affect the outcome of the upcoming election of directors.⁷⁶

The amendment highlighted the distinction between proposals that would result in immediate election contests and those that “would simply establish a process for shareholders to wage a future election contest.”⁷⁷ Consequently, the Commission narrowed the applicability of the election exclusion by prohibiting companies from omitting proposals seeking to establish procedures for the inclusion of director nominees in future company proxy materials.⁷⁸

72. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, and 15 U.S.C.) [hereinafter Dodd-Frank Act]. Section 971 of the Dodd-Frank Act provided the SEC with the authority to promulgate “proxy access” rules. These rules allow specified shareholders to include nominees for the board of directors in company proxy materials. *Id.*; see Facilitating S’holder Dir. Nominations, Securities Act Release No. 33-9136, Exchange Act Release No. 34-62764, Investment Company Act Release No. 29384, 75 FR 56668-01 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

73. Securities Act Release No. 33-9046, *supra* note 68; Securities Act Release No. 33-9136, *supra* note 72 (adopting Rule 14a-11, which allowed shareholders to include nominees for director elections in company proxy materials if those joining in the nominations held at least 3% of the corporation’s voting securities for at least three years and specifically disclaimed any intent to seek control).

74. See Securities Act Release No. 33-9046, *supra* note 68.

75. By including the provisions “where it ‘nominates a specific individual for election to the board of directors,’ and where it could otherwise ‘affect the outcome of the upcoming election of directors,’” the Commission intended to distinguish between proposals that would result in immediate election contests and those that would establish procedures for shareholders to wage future election contests. See Securities Act Release No. 33-9136, *supra* note 72, at 2.

76. 17 C.F.R. § 240.14a-8(i)(8) (2010); see Facilitating S’holder Dir. Nominations, Securities Act Release No. 33-9259, Exchange Act Release No. 34-65343, Investment Company Act Release No. 29788, 2011 WL 4101082, at 1 (Sept. 15, 2011) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

77. See *AFSCME v. Am. Int’l Grp., Inc.*, 361 F. Supp. 2d 344, 347 (S.D.N.Y. 2005), *rev’d*, 462 F.3d 121, 128 (2d Cir. 2006) (“The 1976 Statement clearly reflects the view that the election exclusion is limited to shareholder proposals used to oppose solicitations dealing with an identified board seat in an upcoming election and rejects the somewhat broader interpretation that the election exclusion applies to shareholder proposals that would institute procedures making such election contests more likely.”).

78. Securities Act Release No. 33-9136, *supra* note 72, at 3.

Under the election exclusion, therefore, access bylaws were no longer subject to automatic exclusion.⁷⁹ The Commission recognized the need to supplement the proxy rule by amending the exclusion to provide individual shareholders with greater flexibility in exercising access rights “such as with a lower ownership threshold, a shorter holding period, or to allow for a greater number of nominees if shareholders of a company support such standards.”⁸⁰ Hence, the amendments were intended to facilitate proxy access through private ordering.⁸¹

C. Staff Interpretation Following the 2010 Amendments

The D.C. Circuit invalidated the shareholder access rule.⁸² As a result, shareholders seeking access were limited to proposals submitted under Rule 14a-8.⁸³ For example, in 2014 the Comptroller of the City of New York submitted approximately seventy-five proxy access shareholder proposals targeting a wide range of companies through what it called the “Boardroom Accountability Project” with the intent to gain universal

79. See, e.g., Medtronic, Inc., SEC No-Action Letter, 2012 WL 1493951, at 1 (June 28, 2012) (permitting inclusion of a proposal requesting that the board amend the company’s governing documents “to allow shareholders to make board nominations”). Shareholder proposals requesting proxy access bylaws largely mirrored the requirements under Rule 14a-11. See *id.* at 5–6. Thus, shareholders recognized the staff’s interpretation of the amendment to the election exclusion served to fulfill the purpose of Rule 14a-11 despite the court vacating the proxy access rule. See *id.* at 1 (allowing for inclusion of proxy access bylaw proposals that mirror the requirements under Rule 14a-11 that went unchallenged under Rule 14a-8(i)(8)).

80. Securities Act Release No. 33-9136, *supra* note 72, at 5–6 (“The rules we adopt today reflect our judgment that the proxy rules should better facilitate shareholders’ effective exercise of their traditional state law rights to nominate directors and cast their votes for nominees. When the federal securities laws establish protections or create rights for security holders, they do so individually, not in some aggregated capacity.”).

81. See *id.* at 7 (stating that the “amendments to Rule 14a-8 will facilitate the presentation of proposals by shareholders to adopt company-specific procedures for including shareholder nominees for director in company proxy materials”).

82. The proxy access rule was quickly challenged in the federal courts, and the amendment was, therefore, stayed. See *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1146 (D.C. Cir. 2011); In re Motion of Bus. Roundtable and the Chamber of Commerce of the U.S. for Stay of Effect of Comm’n Facilitating S’holder Dir. Nominations Rules, Securities Act Release No. 33-9149, Exchange Act Release No. 34-63031, Investment Company Act Release No. 29456, 2010 WL 3862548 (Oct. 4, 2010). Consequently, the staff interpreted the election exclusion in accordance with its prior interpretation that shareholder proposals “relating to a nomination or an election for membership” on the board of directors or “a procedure for such nomination or election” were excludable. See, e.g., Gen. Elec. Co., SEC No-Action Letter, 2010 WL 5124307, at 1 (Feb. 1, 2011) (proposing that the board of directors request, from the eight largest shareholders, nominees to the slate of nominees submitted by the board at each annual meeting for election to the board). The court found the rule was “arbitrary and capricious” under the Administrative Procedure Act and struck down the regulation on July 22, 2011, for failing to “adequately [] consider the new rule’s effect upon efficiency, competition, and capital formation. *Bus. Roundtable*, 647 F.3d at 1146, 1148.

83. Although the D.C. Circuit vacated the proxy access rule, the amendments to Rule 14a-8 remained unscathed. See generally *Bus. Roundtable*, 647 F.3d at 1156; see also Securities Act Release No. 33-9259, *supra* note 76, at 1 (“The Court’s order did not affect the amendment to Rule 14a-8, which was not challenged in the litigation Accordingly, those rules and amendments are effective upon publication of this notice in the Federal Register.”).

proxy access.⁸⁴ Given the amendments adopted in 2010, the proposals were generally not subject to the election exclusion.⁸⁵

In the years following the amendment, the staff considered a modest number of proxy access proposals.⁸⁶ Instead, shareholders focused on implementing measures that would ensure greater board accountability and that related to board composition. Significant support for governance proposals to separate the chair and CEO, elect directors annually, implement majority voting, and declassify boards⁸⁷ reflected investor interest in board

84. Boardroom Accountability Project, N.Y.C. COMPTROLLER, <http://comptroller.nyc.gov/boardroom-accountability/bap-proxy-access-proposal/> (last visited Jan. 16, 2016); Elizabeth A. Ising & Kasey L. Robinson, *Recent Developments Related to the SEC's Shareholder Proposal Rule*, 2015 BUS. L. TODAY 1, 2 (July 2015). A list of the seventy-five companies targeted is available on the New York Comptroller's website: <http://comptroller.nyc.gov/boardroom-accountability/bap-companies/>. Under the proxy access proposals, a shareholder must have owned at least 3% of the company's stock for at least three years, and their nominees could not exceed 25% of the board, mirroring the requirements of the vacated Rule 14a-11. *See supra* note 73. The proposals spurred action on the part of other shareholders resulting in an additional thirty-three similar proposals. Ising & Robinson, *supra*, at 2; *see* Tara Bhandari, Peter Iliev & Jonathan Kalodimos, *Public Versus Private Provision of Governance: The Case of Proxy Access*, SOC. SCI. RES. NETWORK 4 (July 24, 2015), available at <http://ssrn.com/abstract=2635695> (noting about 160 proxy access proposals were submitted over four proxy seasons since the adoption of the amendment). A majority of the proposals gained shareholder approval and additional companies adopted proxy access bylaws in response to the project. *See, e.g.*, Expeditors Int'l of Wash., Inc., SEC No-Action Letter, 2015 WL 186754 (Feb. 5, 2015) ("including large cap companies such as General Electric and Bank of America" and Prudential Financial, which did not receive such a proposal).

85. Following the 2010 amendments, companies no longer sought no-action relief for proxy access proposals under the election exclusion and received a modest number of proxy access proposals from shareholders over the next few years. *See* Ising & Robinson, *supra* note 84, at 2. In the 2012 proxy season, twenty-three access proposals were submitted with only nine voted on. *See Proxy Access Proposals – Review of 2012 Results and Outlook for 2013*, SULLIVAN & CROMWELL LLP (June 19, 2012), https://www.sullcrom.com/siteFiles/Publications/Proxy_Access_Proposals_Review_of_2012_Results_and_Outlook_for_2013-7-20-2012.pdf. The proposals were excluded for grounds other than under the election exclusion. *See id.*

86. Approximately fifty-seven proxy access proposals were submitted between 2011 and 2014, with only ten companies adopting proxy access. *See* Ising & Robinson, *supra* note 84, at 2.

87. *See* Brink's Co., SEC No-Action Letter, 2014 WL 556034 (Jan. 17, 2014) (proposing "that the company take the steps necessary to reorganize the board into one class"); *see also* Kinetic Concepts, Inc., SEC No-Action Letter, 2011 WL 202114 (Apr. 5, 2011); McDonald's Corp., SEC No-Action Letter, 2011 WL 190606 (Mar. 15, 2011), W. Union Co., SEC No-Action Letter, 2011 WL 826928 (Feb. 11, 2011).

accountability.⁸⁸ Where such proposals had the capacity to impact an existing board, the staff allowed proponents to revise them to specifically avoid affecting the eligibility of existing directors.⁸⁹

Additionally, the staff considered a number of proposals requesting boards to hold competitions to select advisors regarding voting at the annual shareholders meetings.⁹⁰ In challenging such proposals, companies argued that the intent of these competitions was to encourage votes in opposition to management's nominees and, thus, constituted an effort to influence the outcome of upcoming director elections.⁹¹ Proponents maintained that such proposals would not affect the impending election or the election process. In support, they argued the use of the word "the" rather than "a" in the exclusionary clause "[o]therwise could affect the outcome of the upcoming election of directors" required proposals to affect the immediate election to be excluded.⁹² The staff, without explanation, permitted exclusion.⁹³

Nonetheless, the 2010 amendments represent a marked shift in the Commission's regulation of proxies. With the election exclusion no longer serving as a basis for omitting proxy access proposals, many companies have either adopted or announced the intention to adopt access bylaws,⁹⁴ and private ordering has become an important issue in the absence of federally mandated proxy access.⁹⁵

88. See *2011 Proxy Season Review: Highlights and Leading Implications*, ERNST & YOUNG (July 2011), [http://www.ey.com/publication/vwluassetsdd/proxyerspectives_cf0029_july2011/\\$file/proxyerspectives_cf0029_july2011.pdf?OpenElement](http://www.ey.com/publication/vwluassetsdd/proxyerspectives_cf0029_july2011/$file/proxyerspectives_cf0029_july2011.pdf?OpenElement); see also Scott Hirst, *Proxy Season 2011: A Tipping Point for Social and Environmental Issues?*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Sept. 18, 2011), <http://corpgov.law.harvard.edu/2011/09/18/proxy-season-2011-a-tipping-point-for-social-and-environmental-issues/>. Support for shareholder proposals seeking declassified boards averaged 74% in the 2011 proxy season. See *2011 Proxy Season Review*, *supra*. Additionally, majority voting proposals received an average of 60% support and proposals seeking to eliminate supermajority provisions received an average of 59% support. See *id.* In the 2012 proxy season, proposals voted on at S&P 500 companies that requested the company separate the roles of CEO and chair increased from 25 to 38. See *2012 Proxy Season Review*, SULLIVAN & CROMWELL LLP (July 9, 2012), https://www.sullcrom.com/siteFiles/Publications/2012_Proxy_Season_Review-7-20-2012.pdf; see also *Considerations for Public Company Directors in the 2012 Proxy Season*, GIBSON, DUNN & CRUTCHER LLP (Jan. 3, 2012), <http://www.gibsondunn.com/publications/Pages/ConsiderationsforPublicCompanyDirectors-2012ProxySeason.aspx>.

89. See *supra* note 87.

90. See, e.g., Caterpillar Inc., SEC No-Action Letter, 2014 WL 356633 (Mar. 24, 2014).

91. See *id.* at 1, 13; see also Amazon, Inc., SEC No-Action Letter, 2013 WL326335 (Mar. 20, 2013); Cisco Sys., Inc., SEC No-Action Letter, 2013 WL 3289106 (Aug. 9, 2013); Costco Wholesale Corp., SEC No-Action Letter, 2012 WL 4459575 (Nov. 20, 2012).

92. See *supra* note 90.

93. See *supra* note 91.

94. See *supra* note 84 and accompanying text.

95. See Bhandari, Iliev & Kalodimos, *supra* note 84, at 12–14 (noting that proxy access proposals have increasingly gained momentum).

III. IMPLICATIONS

Election to the board of directors represents perhaps the most important function for shareholders.⁹⁶ Directors—not shareholders—manage the company.⁹⁷ Accordingly, as a means of holding elected representatives accountable and providing incentives for directors to focus on shareholder interests, “the powers of corporate democracy are at [the shareholders’] disposal to turn the board out.”⁹⁸

Rule 14a-8, however, restricts shareholders’ ability to influence board composition. From the outset, the Commission prohibited the use of the Rule to nominate directors.⁹⁹ The Rule likewise prohibited shareholders from including proposals in the proxy statement that would have provided access to the proxy materials for their nominees.¹⁰⁰ While the 2010 revisions provided shareholders with greater flexibility, staff interpretation continues to restrict shareholder efforts to influence the composition of the board.¹⁰¹

A. State Corporate Law, the Federal Proxy Rules, and Corporate Governance

Shareholders and directors each have a role in controlling the corporation. Because “different firms require different governance structures to effectively mitigate transaction costs,”¹⁰² defining these roles should be left to the individual shareholders and companies based on their rights and responsibilities under state corporate law.¹⁰³ Nonetheless, the proxy rules

96. PL Capital, LLC v. Bonaventura, Del. Ch., C.A. No. 19068, tr. at 27, Noble, V.C. (Sept. 28, 2001) (“Shareholders don’t run the company. Under Section 141, the directors do. Thus, for an ongoing corporate venture, the election of directors may be the most . . . important action[] that shareholders can take. And without a choice of candidates, there can be no election or exercise of that franchise.”); see *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”); see also Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 679–82 (2007) (discussing the importance of shareholder franchise). The SEC chose to exclude the application of the shareholder proposal rule to director elections. See Exchange Act Release No. 34-3347, *supra* note 11, at 7–12; see Robert B. Thompson, *Delaware, the Feds, and the Stock Exchange: Challenges to the First State as First in Corporate Law*, 29 DEL. J. CORP. L. 779, 798 (2004).

97. See DEL. CODE ANN. tit. 8, § 141 (2015).

98. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985).

99. See Exchange Act Release No. 34-378, *supra* note 5.

100. See discussion *supra* Part I.

101. See Securities Act Release No. 33-9046, *supra* note 68, at 1–2; see also Fisch, *supra* note 38, at 439 (“Existing SEC rules continue to impose extensive regulatory requirements on the exercise of shareholder nomination rights and to frustrate shareholder efforts to enhance those rights through state law mechanisms.”).

102. Smith, Wright & Hintze, *supra* note 50, at 188 (rejecting “a onsize-fits-all governance system where private ordering is not feasible”).

103. *UniSuper Ltd. v. News Corp.*, No. 1699-N, 2005 WL 3529317, at *6 (Del. Ch. Dec. 20, 2005) (recognizing that “the board’s power—which is that of an agent’s with regard to its principal—derives from the shareholders, who are the ultimate holders of power under Delaware law”); see Fisch, *supra* note 38, at 486–490 (“Several distinctive features render state corporate law robust to firm-specific differences and market and regulatory developments These features, which are absent in federal securities regulation, enable state law to maintain an equilibrium in the allocation of power between managers and shareholders.”).

substantively impact the voting process and affect the balance of power between management and shareholders as well as overall corporate governance structure.¹⁰⁴

The approach has not been neutral. The Commission's intervention into the governance process has reduced shareholder rights under state corporate law.¹⁰⁵ Nor has the Commission justified this approach as optimal for shareholders.¹⁰⁶ Rather, the election exclusion has served to insulate the board of directors from replacement and allowed management to control director elections.¹⁰⁷ This control has resulted in a governance structure that deprives shareholders of the ability to hold directors accountable.¹⁰⁸

Moreover, the staff's interpretation of the recently revised election exclusion suggests that it will still be broadly interpreted to interfere with the ability of shareholders to effectively choose directors that will serve in their best interests. For example, the staff recently allowed for the exclusion of proposals merely designed to increase the amount of advice available to shareholders with respect to matters included in the proxy statement.¹⁰⁹ These proposals would have allowed shareholders to vote to appoint an independent proxy advisory firm to provide advice regarding matters to be voted on at the annual shareholders meeting.¹¹⁰ Thus, the proposals were about the selection of such firms for guidance in future matters including director elections.

In one such proposal, proponents called for the board to "hold a competition for giving public advice on the voting items in the proxy filing for

104. See Fisch, *supra* note 13, at 1170 ("[T]he SEC's proxy rules are not passive attempts to implement shareholders' state law rights in an increasingly large and impersonal voting system. Instead, the rules change the voting process, both by determining issues upon which shareholder democracy is appropriate and by structuring the way in which such democracy can be exercised.")

105. See Brown, *supra* note 3, at 88–89.

106. See Fisch, *supra* note 38, at 454 ("Critically, the SEC did not defend either its historically restrictive approach to proxy access or its new regulations in terms of a normative perspective. In other words, the SEC did not purport to be identifying an appropriate level of shareholder nominating or voting power or to ground its regulations in identified deficiencies in existing corporate governance mechanisms."). Instead, the Commission stated it had "considered changes when it appeared that the process was not functioning in a manner that adequately protected the interests of investors." See Securities Act Release No. 33-9136, *supra* note 72, at 3.

107. See generally Bebchuk, *supra* note 96, at 688–94 (discussing management's ability to control board elections and recognizing that "even when shareholder dissatisfaction with board actions and decisions is substantial, challengers face considerable impediments to replacing boards").

108. See Brown, *supra* note 3, at 86–89; see also Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 336–37 (2010) ("There is a substantial body of empirical evidence that is consistent with the view that making boards more accountable by invigorating corporate elections increases shareholder value.")

109. See *supra* note 91.

110. See, e.g., Caterpillar, Inc., SEC No-Action Letter, 2014 WL 356633 (Mar. 24, 2014).

the . . . 2015 annual shareowners meeting.”¹¹¹ This proposal made no mention of the election of directors.¹¹² The company, however, asserted that by seeking alternative advice to that provided by management, the proposal suggested that the intent “to select proxy advisors that may encourage votes in opposition to the director candidates nominated by management” was to oppose management’s nominees for the board.¹¹³

The proposal simply sought additional advice.¹¹⁴ Moreover, the provision did not apply to the meeting that year but only to subsequent meetings.¹¹⁵ As a result, the proposal did not affect the outcome of the upcoming meeting. Nonetheless, the staff without explanation permitted exclusion.¹¹⁶ The staff flatly concluded that the proposal “could affect the outcome of the upcoming election of directors” placing the exclusion and the staff’s corresponding interpretation in direct conflict with shareholders’ rights under state corporate law.¹¹⁷

B. A Call for Reform

The amendments adopted in 2010 narrowed the election exclusion.¹¹⁸ Although specifying the types of proposals that could be excluded, subsection (i)(8) also contained a catch all that applied to any proposal that “[o]therwise could affect the outcome of the upcoming election of directors.”¹¹⁹ Initial interpretations suggest that the staff intends to construe the

111. *Id.*

112. The company argued that it was enough that the proposal cross-referenced a web site that did mention the election of directors. *See id.* (Letter from Caterpillar, Jan. 24, 2014) (“[T]he Proposal cites a website address for an article that states in its opening paragraphs that implementing an arrangement such as that advocated in the Proposal would affect ‘voting influence on director elections.’ It is this type of effort to influence upcoming directors elections through the Rule 14a-8 shareholder proposal process that provides the basis for Rule 14a-8(i)(8).”).

113. The company asserted that a reference to a need for recommendations not identical to those propounded by management was somehow designed to influence the election of directors. *See id.* (“The Proposal’s supporting statement explicitly seeks to assist shareholders who ‘lack the time and expertise to make the best voting decisions, yet prefer not to always follow directors’ recommendations,’ thus suggesting that the intent is to select proxy advisors that may encourage votes in opposition to the director candidates nominated by management.”).

114. *See id.*

115. *See id.* (“Caterpillar’s upcoming election of directors will be in 2014, conducted via Caterpillar’s 2014 proxy. The Proposal would not pay for proxy voting advice regarding Caterpillar’s 2014 proxy, so it would not affect the outcome of the upcoming election of directors.”).

116. *See id.* (permitting exclusion of a proposal requesting the board hold a contest to select advisors in regard to voting on the election of directors). The provision specifically provided that it was to be interpreted consistent with a board’s fiduciary duties and with state law. *Id.*

117. The power to vote on the election of directors inherently incorporates the power to affect the outcome of such election. *See, e.g.,* DEL. CODE ANN. tit. 8, § 211(b) (2015) (providing that “an annual meeting of stockholders shall be held for the election of directors”).

118. *See* discussion *supra* Section II.B.

119. 17 C.F.R. § 240.14a-8(i)(8) (2010).

language broadly.¹²⁰ Thus, as the election exclusion stands today, shareholder franchise will continue to be impeded.¹²¹

The purpose of proxy regulation was to ensure “fair corporate suffrage” and to facilitate shareholder involvement in internal governance affairs.¹²² Accordingly, to avoid impeding shareholders’ rights under state corporate law further, the staff must limit its interpretation of the election exclusion to apply solely to proposals that specifically affect upcoming elections for the board of directors.

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120. See *supra* notes 109–17 and accompanying text.

121. See generally Fisch, *supra* note 38, at 437–39 (arguing that “[e]xisting SEC rules continue to impose extensive regulatory requirements on the exercise of shareholder nomination rights and to frustrate shareholder efforts to enhance those rights through state law mechanisms”).

122. Congress acted in response to abuses by corporate insiders and enacted the federal securities laws with the purpose of protecting investors. See Exchange Release No. 34-41, *supra* note 1, at 4. Indeed, proxy regulation was a result of Congress’ focus on “fair corporate suffrage” in recognition of management’s interference with shareholders’ voting rights. See H.R. REP. NO. 1838, 73d Cong. (1934). Introduced by Representative Rayburn, the purpose of the bill was described as seeking “to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges.” *Id.* at 2 (addressing shareholder voting by recognizing that “[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies.”).

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