A COUNTERINTUITIVE REFORM: THE INHERENT HINDRANCE TO PROXY ACCESS IN RULE 14A-8'S PIPELINE

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Proxy access, a mechanism through which shareholders can place director nominees on the company's proxy materials at the company's expense, is an invaluable tool of corporate governance intended to keep boards accountable to their shareholders. Recognizing the necessity of granting shareholders this power in the aftermath of the financial crisis, the United States Securities and Exchange Commission promulgated Rule 14a-11, which granted certain shareholders the right to place director nominees on the corporate ballot. However, in the wake of the Business Roundtable challenge and the subsequent D.C. Circuit court of Appeals decision to vacate Rule 14a-11, proxy access for shareholders is now only available through the private ordering system of Rule 14a-8. This Note systematically analyzes whether shareholder-sponsored proxy access proposals can operate efficiently within Rule 14a-8's framework and its existing common law. Although Rule 14a-8 is meant to equip shareholders with a vehicle to implement proxy access, this Note argues that shareholders will be unable to reap the benefits of proxy access unless the SEC takes concerted action to clarify how the rule will apply to proxy access proposals. The current application of Rule 14a-8

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common law to proxy access proposals results in an easy-to-manipulate, systematic advantage for management that will effectually strip shareholders of any meaningful opportunity to express their preferences on the rules governing shareholder access to the ballot. Additionally, the lack of SEC clarification with respect to this issue is not only counterproductive to the intended reform, but also compromises the system as a whole and places its functionality for this purpose in serious question. This Note identifies inherent issues that came to light after the 2012 proxy season regarding the application of the private ordering system to proxy access. In this manner, it attempts to provide the framework for certain critical decisions the SEC will face before the next proxy season and encourages action by the SEC Commissioner to clarify for the staff, shareholders, and corporations that proxy access is unique and will operate differently within Rule 14a-8 than other shareholder proposals.

I. INTRODUCTION

Granting shareholders the right to place director nominees on corporate proxy materials, a concept commonly known as proxy access, has been a topic of discussion for decades.[1] Some have hailed proxy access as a key corporate governance initiative that will more closely align director action with shareholder desire.[2] Others have denounced the notion of proxy access as a value-reducing blunder that would negatively impact public companies and their boards.[3] Proxy access has even been thought to be ineffective by certain critics under the claim that additional financial expenditure is necessary to win a proxy contest, even if the shareholder-sponsored director is listed on the corporate ballot.[4] In the past few years, however, the proxy access debate has shifted from whether proxy access is desirable, to what form would be most preferable.[5] This shift is likely due to the increasingly shared sentiment among shareholders that current monitoring devices are insufficient to control runaway board members, and that these board members are entrenched in their positions under the current proxy voting system. Thus, proxy access has resurfaced as a viable corporate governance tool to increase director accountability.

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[1] *See, e.g.*, D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 131–32 (2011) (describing how, in the late 1990s, shareholder activism took hold as and shareholders looked to bylaws as an "avenue for direct shareholder participation in corporate governance").

[2] *See, e.g.*, Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 340 (2009).

[3] *See, e.g.*, Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003).

[4] Stephen Davis & Jon Lukomnik, *Proxy Access: Don't Get Caught Up in the Hype*, COMPLIANCE WEEK, Nov. 1, 2010, at 501.

[5] Bebchuk & Hirst, *supra* note 2, at 340; Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361, 366 (2009).

Moreover, the events of the last two years have set a defined stage for shareholder proxy access. In September 2010, the United States Securities and Exchange Commission ("SEC") promulgated final rule 17 C.F.R. §§ 200, 232, 240 and 249 under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act in an attempt to institute considerable reform to the shareholder proxy rules and better facilitate shareholder director nominations. This rule included a provision that mandated public companies to include director-nominees of long-term, prominent shareholders in the company's proxy materials,[6] as well as an "opt-in" provision that allowed private ordering for proxy access by less significant, more recent shareholders.[7] Pending a challenge by Business Roundtable to these rules, both provisions were stayed.[8] Recently, the U.S. Court of Appeals for the D.C. Circuit struck down the mandatory provision of the rule (Section 14a-11) in *Business Roundtable v. SEC*, holding that the practical cost of implementing this mandate outweighed the expected benefits.[9] While this decision placed a crimp on shareholder proxy access as initially envisioned by the SEC, it simultaneously lifted the stay on the private ordering provision, which was in full operative use for shareholders in the 2012 proxy season. Now, proxy access is a private ordering regime, and shareholders are in a unique position to fashion their own rules governing eligibility for placing a director-nominee on the corporate ballot. However, this important governance tool may in fact be illusory, depending

[6] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668-01, 56,741 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

[7] *Id.*

[8] Motion of Bus. Roundtable for Stay, Securities Act Release No. 33-9149, Exchange Act Release No. 34-63031, Investment Company Act Release No. IC-29456, 2010 WL 3862548 (Oct. 4, 2010).

[9] Bus. Roundtable v. SEC, 647 F.3d 1144, 1156 (D.C. Cir. 2011) (finding that the SEC acted "arbitrarily and capriciously").

on how the SEC allows Rule 14a-8 common law and management-exclusion powers to be utilized.

Originally, Rule 14a-8 included a stark prohibition on shareholder proxy access proposals from appearing on the corporate ballot. The amendment to Rule 14a-8 removed this prohibition; however, it did not create an express exception for proxy access to the Rule 14a-8 common law. Furthermore, the SEC Commissioner has remained silent on this issue, offering no guidance to the staff with respect to ruling on management-sponsored petitions to exclude proxy access on the bases of Rule 14a-8 exclusion powers. The appearance of shareholder proxy access proposals on the corporate ballot is thus contingent on its operation within Rule 14a-8 and the SEC's decisions in its no-action rulings.

This Note conducts an in-depth analysis of Rule 14a-8 and assesses the viability of proxy access proposals under its reign in light of the applicable common law, corporate management's use of exclusionary powers, and SEC decision making in the 2012 proxy season. In finding the private ordering system imperfect to achieve the goals set out by the Commission, this Note suggests that the SEC take preemptive steps to fortify the Rule 14a-8 pipelines by issuing an interpretive release making clear that proxy access proposals are unique from other Rule 14a-8 proposals, and that the SEC will therefore deny no-action requests to exclude such proposals on traditional bases where management manipulation is evidenced. Part II of this Note provides a brief review of the ongoing debate between default rules and private ordering. Part III presents an in-depth analysis of the Rule 14a-8 common law and structure that is directly in conflict with facilitating shareholder proxy access and the SEC's original intent. Part III also discusses arguments for differentiating proxy access from other Rule 14a-8 proposals. Part IV concludes SEC action thus far has been inadequate to protect the intended shareholder right to the ballot. It further highlights the implications of these actions, and suggests steps that the SEC may take to cure the evident problems within the currently established private ordering system.

II. THE CLASSIC DEBATE OVER PRIVATE ORDERING

Legal scholars and corporate advocates are no strangers to the notion of proxy access; it has been a proposed solution for ineffective corporate governance since the early 1990s.[10] The need for reform emerged in response to a recognized disconnect between the fundamental idea of shareholder primacy in U.S. corporate law and the protection incumbent directors receive as part of the established corporate structure, even when prioritizing director value-enhancing decisions above those of shareholders.[11] Activists and scholars recognize proxy access as the most practical option and principal method to address the "shortcomings in corporate democracy," namely, the considerable obstacles to director removal, and to holding directors accountable for decisions unfavorable to maximizing shareholder value.[12] There is longstanding disagreement, however, as to the optimal vehicle for shareholder proxy access.[13] The case for

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[10] Smith et al., *supra* note 1, at 131.

[11] Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy*, 16 STAN. J.L. BUS. & FIN. 1, 3 (2010) (citing methods such as staggering boards as obstacles to removing directors); *see also* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 861 (pointing to staggered boards and the cost of proxy contests as hindrances to shareholders' ability to replace unfavorable boards with a team that would enact more favorable resolutions).

[12] Sprague & Lyttle, *supra* note 11, at 19 ("The principal method of addressing claimed shortcomings in corporate democracy is to provide shareholders with proxy access."); *see also* Bebchuk, *supra* note 11, at 856 ("[S]hareholders seeking to exercise their theoretical power to replace directors face substantial impediments.").

[13] *See generally* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1758 (2006) (advocating the status quo of limited shareholder voting rights, or a no-access default); Jack Gravelle, *Proxy Access for All Shareholders*, 12 TRANSACTIONS: TENN. J. BUS. L. 173, 178 (2011) (promoting proxy access for all shareholders, not just majority holders); Brett H. McDonnell, *Setting Optimal Rules for Shareholder Proxy Access*, 43 ARIZ. ST. L.J. 67, 112–15 (2011) (discussing no-proxy-access default rules, penalty default rules, and

the two most debated options—a default rule or a private ordering regime—is most comprehensively reviewed, theorized, and discussed in the exchange between Lucian A. Bebchuk and Joseph A. Grundfest.

Bebchuk vehemently argues that under the current corporate structure, the less restrictive approach of private ordering with a no-access default will fail to advance the end goal of increased shareholder involvement in director nominations. This is due to what Bebchuk calls the "fundamental asymmetry" in power between management and shareholders with respect to employing governance initiatives.[14] A central factor that contributes to this asymmetry is that shareholders largely submit precatory proposals, rather than binding bylaw amendments.[15] This places management in the advantageous position of assuming the role of final adjudicator with regard to enactment; despite majority shareholders' explicit preference in favor of a precatory proposal, the board may elect not to follow.[16] Shareholders often face this very type of substantial pushback from management when attempting to enact "rules-of-the-game" decisions, and often management will refuse to initiate such changes in spite of strong support in precatory resolutions.[17]

Furthermore, with final implementation power, management also has the option to pass a distortion of a submitted shareholder proposal and enact a rule

altering rules as potential options); Reed T. Schuster, *Rule 14a-11 and the Administrative Procedure Act: It's Better to Have Had and Waived, Than Never to Have Had at All*, 95 MINN. L. REV. 1034, 1055 (2011) (advocating a Rule 14a-11 mandate to increase shareholder rights and improve corporate governance).

[14] Lucian A. Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 492 (2002).

[15] Bebchuk & Hirst, *supra* note 2, at 340.

[16] *Id.* at 345.

[17] Bebchuk, *supra* note 11, at 852. Bebchuk demonstrates this trend using empirical data relating to destaggering board initiatives, which shareholders suggested in precatory resolutions multiple times to no avail, as a large percentage were not implemented by management. *Id.* at 854.

significantly more restrictive than those favored by the voting shareholders.[18] This places shareholders—who only have access to a private ordering regime—in a difficult position, since enacting the regime they envision likely depends on management sentiment. To avoid this large hindrance and ensure that shareholders who want to utilize the proxy access system will not be stymied by the realities of the corporate power scheme, Bebchuk advocates an access default that would grant to shareholders who meet the minimum thresholds direct access to the proxy statement. Bebchuk reconciles an access default with the central counterargument, that default rules chosen by public officials will not be optimal for all companies, by employing his "reversible defaults" logic.[19] Under this reasoning, it is more favorable to enact an access default since it is "more difficult for shareholders favoring proxy access to opt out of a no-access default than it would be for shareholders favoring no-access to opt out of a federal access regime."[20]

Grundfest holds fast to the opposite argument: that the special advantages of the opt-in private ordering regime, which allows shareholders to construct individualized proxy access proposals that fit their company's needs, is more advantageous than a randomized, generic access default rule.[21] A fully enabling proxy access rule, argues Grundfest, that would empower shareholders to decide "whether, when, and how proxy access should be permitted," would avoid the inherent inconsistencies that exist in the Mandatory Minimum Rule alternative.[22] Specifically, Grundfest is

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[18] Bebchuk & Hirst, *supra* note 2, at 347.

[19] Bebchuk, *supra* note 11, at 868; *see also* Bebchuk & Hamdani, *supra* note 14, at 492 (claiming the "better strategy" is to employ the rule that is "designed to facilitate change in the event that the chosen default arrangement turns out to be disfavored by shareholders").

[20] Bebchuk & Hirst, *supra* note 2, at 333–34.

[21] Grundfest, *supra* note 5, at 366.

[22] *Id.* at 368. One such inconsistency Grundfest cites is that shareholders are selectively intelligent: competent to elect directors but incompetent to determine the rules governing the election of directors. *Id.* at 370.

critical of allowing the SEC, which has "no particular insight as to the preferences of the shareholder majority that might be viewed as value-maximizing at each company subject to the proxy access rules," to essentially "guess" the appropriate default rule.[23] Rather, as stated directly by former Commissioner Paredes, permitting shareholders to "include in the company's proxy materials a bylaw proposal that would allow shareholders proxy access" would be a rule amendment resting on "firmer legal ground" than the Mandatory Minimum Access Rule, since it would not only be tailored to company specifications but also to specific jurisdictional restrictions (if any).[24]

After the SEC finalized the rule amendments to Rule 14a-11 and Rule 14a-8, it seemed as if Bebchuk had won. Rule 14a-11 established the access default Bebchuk had advocated and took it one step further, calling for mandatory inclusion of shareholder director nominees in the company proxy materials (at the company's expense) so long as the shareholder reached the minimum threshold of three percent ownership for over three years.[25] Although Grundfest supporters found a skeletal outline of a private ordering regime in the Rule 14a-8 amendment, which narrowed the election exclusion to effectively allow "opt-in" proxy access shareholder proposals, it was a far cry from "enabling." Passed in conjunction with an access minimum, the Rule 14a-8 amendment only allowed for proxy proposals less stringent than the minimum thresholds of Rule 14a-11, and it could not limit the availability of Rule 14a-11.[26]

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[23] Grundfest, *supra* note 5, at 366.

[24] *Id.* at 367 (citing Troy A. Paredes, Comm'r, SEC, Statement at Open Meeting to Propose Amendments Regarding Facilitating Shareholder Director Nominations (May 20, 2009), *available at* www.sec.gov/news/speech/2009/spch052009tap.htm).

[25] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56674–75 (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

[26] *Id.* However, proposals that provide additional means for shareholder eligibility to nominate directors would be permitted. DAVIS POLK & WARDWELL LLP, SUMMARY OF PROXY ACCESS RULES 1 (2010),

Grundfest may have lost in the initial SEC rule proposal, but Bebchuk could not ultimately claim victory. In July 2011, the U.S. Court of Appeals for the D.C. Circuit vacated Rule 14a-11 as "arbitrary and capricious" (just as Grundfest had predicted)[27] since the Commission failed to collect the "crucial datum" which would confirm that the rule would "facilitate enough election contests to be of net benefit."[28] The Rule 14a-8 amendment, however, was unaffected by the court's decision. Thus, when the SEC decided not to appeal the decision, the Rule 14a-8 amendment went into effect upon expiration of the stay and finalization of the Court of Appeals decision.[29] This left Grundfest with a mode for his ideal private ordering system. Rule 14a-8 established a vessel for a completely enabling proxy access vehicle, whereby shareholders with one percent or $2000 ownership for one year could submit a proposal relating to the procedure of director elections.[30] In practice, however, the system's existing standards create considerable imperfections that sully Grundfest's "enabling" proxy access model that was originally envisioned to be viable within Rule 14a-8.

III. THE PIPELINES OF RULE 14A-8 AND INAPPLICABILITY TO PROXY ACCESS

Private ordering for proxy access was available to shareholders for the 2012 proxy season under Rule 14a-8. Of

available at www.davispolk.com/files/uploads/Corporate%20Governance/090710_pa_summary.pdf (hereinafter DAVIS POLK MEMO).

[27] *See* Grundfest, *supra* note 5, at 375.

[28] Bus. Roundtable v. SEC, 647 F.3d 1144, 1153 (D.C. Cir. 2011).

[29] Press Release, SEC, Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation (Sept. 6, 2011), *available at* www.sec.gov/news/press/2011/2011-179.htm.

[30] 17 C.F.R. § 240.14a-8 (2012). This is also true in light of the *CA, Inc.* decision, which affirmed that procedural bylaws regarding proxy access are proper subjects for shareholders and do not violate state law as long as they include a fiduciary-out clause. *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 240 (Del. 2008).

the shareholder-sponsored proposals that were made, a majority were challenged by management on the bases of Rule 14a-8 exclusion rules and common law.[31] Although newly narrowed, Rule 14a-8 is not novel; it comes with a barrage of common law and SEC interpretations that define its shape and usefulness to expectant shareholder activists. Understanding the pipelines of Rule 14a-8 and how its existing common law interacts with proxy access proposals is thus pertinent to the analysis of whether shareholders truly have an enabling access system under the current private ordering scheme.

A. Differentiating Proxy Access and the Threat of Rule 14a-8 Exclusions

The dilemma for shareholders wishing to institute proxy access posed by the partially amended Rule 14a-8 only exists if management is likely to utilize its exclusion powers in an abusive manner, using advantages or technicalities under the existing rule as an excuse to exclude meritorious shareholder proposals for the primary purpose of preventing proxy access. This potential consequence touches upon an important premise of the argument that proxy access may not fit within the existing Rule 14a-8 framework despite the SEC amendments: proxy access is inherently different from

[31] *See* Bank of Am., SEC No-Action Letter, (Mar. 7, 2012), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/kennethsteiner030712-14a8.pdf; Charles Schwab Corp., SEC No-Action Letter, 2012 WL 77230 (Mar. 7, 2012); Chiquita Brands Int'l Inc., SEC No-Action Letter, 2012 WL 36452 (Mar. 7, 2012); Dell Inc., SEC No-Action Letter, 2012 WL 1615814 (Mar. 30, 2012); Goldman Sachs Group, Inc., SEC No-Action Letter, (May 3, 2012), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/jamesmcritchie030712-14a8.pdf; KSW, Inc., SEC No-Action Letter, 2012 WL 91382 (Mar. 7, 2012); MEMC Elec. Materials, Inc., SEC No-Action Letter, 2012 WL 243724 (Mar. 7, 2012); Sprint Nextel Corp., SEC No-Action Letter, 2012 WL 6962628 (Mar. 7, 2012); Staples, Inc., SEC No-Action Letter, 2012 WL 364041 (Apr. 13, 2012); Textron Inc., SEC No-Action Letter, 2011 WL 6859126 (Mar. 7, 2012); Wells-Fargo & Co., SEC No-Action Letter, 2011 WL 6935318 (Mar. 7, 2012); Western Union Co., SEC No-Action Letter, 2012 WL 173774 (Mar. 7, 2012).

other shareholder proposals that fit well within this framework, since the prospect of being unseated by a future shareholder nominee results in a definite and personal conflict for management considering proxy access regimes. Management interests in considering proxy access will widely diverge from that of shareholders, largely because of the likelihood of being unseated in a future election should a shareholder-friendly proxy access regime be instituted. This poses a very different circumstance from the social reform proposals that Rule 14a-8 has historically tackled, where management objection was more often based on company policy rather than personal motivation.

The special circumstances surrounding proxy access proposals may bolster Bebchuk's argument for optimal defaults.[32] Perhaps these rules should favor shareholders, given that the traditional obstacles to collective action in the modern corporate structure—namely, wide dispersal, disorganization, and lack of communication—are coupled with the potential added hindrance of management's assumedly general aversion to proxy access. In reality, the framework of Rule 14a-8 may serve to favor management, especially in light of the Rule 14a-8(i) exclusion bases.

The SEC recognized these issues, and the need to provide a default rule in order to implement a successful proxy access system, when it passed Rule 14a-11 in conjunction with the Rule 14a-8 amendment. In its final release, the SEC indicated the necessity of a mandatory rule lay in part on the ease with which "companies . . . could frustrate shareholder efforts to establish procedures for shareholders to place board nominees in the company's proxy materials by litigating the validity of a shareholder proposal establishing such procedures, or possibly repealing shareholder-adopted bylaws establishing such procedures."[33] For this reason, the staff concluded that simply modifying the existing Rule 14a-8 rules without also adopting a mandatory default would

[32] *See* Bebchuk & Hamdani, *supra* note 14, at 492.

[33] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,672 (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

"not achieve the Commission's stated objectives."[34] Proxy access was intended to be treated differently from other proposals in this respect, and this indication suggests that Rule 14a-8 alone may provide an imperfect private ordering system for the purpose of facilitating shareholder director nominations.

Despite the attempt to differentiate proxy access, shareholders were ultimately left with a rule subject to a plethora of hindrances embedded in Rule 14a-8 management exclusionary powers. Most problematic is the potential for the Rule 14a-8 common law to apply to proxy access proposals. The issue with subjecting proxy access proposals to Rule 14a-8 common law lies in the diametrical difference between the staff's mindset during the years when the common law was formed and its current objective. The staff's interpretation of Rule 14a-8 exclusion powers will be integral to the lifespan of proxy access within this system, and may ultimately be counterproductive to the Commission's attempt to facilitate shareholder access to the ballot. In some respects, such as the staff's interpretation of Rule 14a-8(i)(10), there is no conflict. However, Rule 14a-8(i)(9) and (12) are two specific examples of commonly used management exclusion powers that seem especially out of place with regard to proxy access proposals, and provide for a legally sound, but logically inapposite, justified bases for exclusion of a shareholder sponsored proxy access proposal.

1. 14a-8(i)(10)

Rule 14a-8(i)(10) allows for management to exclude shareholder proposals if the company has already "substantially implemented" them. SEC evaluation of when a proposal is "substantially implemented" is narrow, presumably to guard against those manipulative schemes whereby management attempts to take advantage of the 40-day window between receipt of a shareholder proposal and

[34] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,672 (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

the deadline for no-action letter requests to implement a self-crafted, management-friendly bylaw.[35] Based on the existing common law, the SEC will discern proposal differences very carefully, and, as seen most notably in the special meeting context, will consider percentage variants between proposals evidence enough to deny an exclusion request based on Rule 14a-8(i)(10).[36] This interpretation made it especially difficult for management to manipulate the procedural rules of Rule 14a-8 to exclude shareholder proposals.

Despite the fact that this kind of common law precedent does not evidence favorable application to management in the proxy access context, at least one firm advisor suggested that management may wish to use Rule 14a-8(i)(10) as a defense to shareholder proxy access proposals,[37] and there was one attempt to exclude on this basis in the 2012 season.[38] After receiving a shareholder proposal this spring, management at KSW, Inc. adopted a proxy access bylaw of their own with higher thresholds for nominating shareholders.[39] In their no-action request, management

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[35] According to Rule 14a-8, shareholders must submit their proposals to management no later than 120 days prior to the dissemination of proxy materials. 17 C.F.R. § 240.14a-8(e)(2) (2012). Shareholders must request a no-action decision from the SEC no later than 80 days prior to the dissemination of proxy materials. 17 C.F.R. § 240.14a-8(j)(1) (2012). This leaves management with a 40-day window between receipt of a shareholder proposal and the deadline for a SEC no-action letter request in which it may potentially craft a more favorable proposal than the proposal submitted by the shareholder.

[36] *See* Allegheny Energy, Inc., SEC No-Action Letter, 2009 WL 796649 (Jan. 15, 2009).

[37] CADWALADER, WICKERSHAM & TAFT LLP, RECENT AMENDMENTS TO RULE 14A-8 AND THE IMPLICATIONS FOR THE 2012 PROXY SEASON 5 n.6 (2011), *available at* www.cadwalader.com/assets/client_friend/092811RecentAmendmentsRule14a-8.pdf (hereinafter CADWALADER MEMO) (suggesting companies pass a corporate-friendly private ordering regime prior to the 2012 season, and then exclude on the well-established basis that the proposal has been "substantially implemented" under Rule 14a-8(i)(10)).

[38] KSW, Inc., SEC No-Action Letter, 2012 WL 91382 (Mar. 7, 2012).

[39] KSW, Inc., Amend. No. 2 to Amended and Restated Bylaws of KSW, Inc. (Form 8-K) (Jan. 31, 2012), *available at* www.sec.gov/

admitted to implementing the regime after receiving the shareholder proposal and explained the reasoning for increasing the threshold requirement as an attempt to better align the ownership threshold with "meaningful" shareholders in light of its market capitalization.[40] It requested exclusion based on Rule 14a-8(i)(10), claiming that the proxy access shareholder proposal was "substantially implemented" via the new company bylaw.

Keeping true to existing interpretations, the SEC denied exclusion on a Rule 14a-8(i)(10) basis.[41] This provides a prime example of a circumstance in which proxy access works well within the Rule 14a-8 framework. Based on this decision, shareholders can be confident in a certain degree of protection against management manipulation of the private ordering system. If management tries to adopt bylaws with high thresholds as a tactic to squash a shareholder-friendly proxy access proposal with lower ownership level requirements, the SEC will, as a matter of Rule 14a-8 common law, not exclude.

This favorable application of Rule 14a-8 common law to the proxy access context makes it seem theoretically unobjectionable as a continued mechanism for shareholder facilitation. However, while proxy access was bolstered by this individual decision, the SEC's continued use of Rule 14a-8 common law to rule on no-action letters involving proxy access proposals did nothing to mitigate the exposure of proxy access to vulnerability in alternate circumstances. These include situations where common law supports exclusion of a meritorious proposal either at the appearance of a conflicting management proposal[42] or, in later years, on

Archives/edgar/data/1004125/000113379612000009/k300962_8k.htm. (implementing a five percent for one year proxy access regime shortly after receiving a two percent for one year shareholder proposal).

[40] KSW, Inc., SEC No-Action Letter, *supra* note 38, at *7.

[41] *Id.* at *1 (noting the "difference in ownership levels required for eligibility," and thus finding it was "unable to concur that the bylaw adopted by KSW substantially implements the proposal").

[42] 17 C.F.R. § 240.14a-8(i)(9) (2012).

the basis of previously failed attempts at instituting proxy access.[43] Thus, whether Rule 14a-8 framework is a viable mechanism for proxy access will be largely dependent on the staff's response to the more obvious misfits between proxy access and established Rule 14a-8 common law.

2. 14a-8(i)(9)

The content of Rule 14a-8(i)(9) is relatively straightforward in its intent to prevent shareholder voting confusion that would result if alternative and conflicting voting options were allowed on the same proxy. It warrants an exclusion if "the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting."[44] Companies must specifically detail the points at which the proposals conflict in order to be successful in their no-action letter requests.[45] The SEC has consistently determined the threshold for exclusion to be the point at which when voted on, the two proposals would result in "inconsistent, inconclusive, or opposing results."[46] This is in an attempt to prevent the potential for "ambiguous results" should both proposals be included and voted upon.[47]

Generally, the SEC will grant no-action letters in situations where the proposals directly conflict, and will deny no-action letter requests in situations where proposals are similar, but there is no apparent danger of alternate or ambiguous results.[48] Management has sought for exclusion

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43 § 240.14a-8(i)(12).

44 17 C.F.R. § 240.14a-8(i)(9) (2012).

45 *Id.*

46 Alliance World Dollar Gov't Fund Inc., SEC No-Action Letter, 2006 WL 3289779, at *6 (Oct. 19, 2006).

47 Dow Chem. Co., SEC No-Action Letter (Jan. 27, 2010), *available at* www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/cheveddenrossi012710-14a8.pdf.

48 *See, e.g.*, Abercrombie & Fitch Co., SEC No-Action Letter, 2005 WL 1036250 (May 2, 2005) (granting no-action letter in support of excluding shareholder proposal for stock options to be performance-based, since it conflicted with company proposal that stock options be time-based); *see*

to apply to many shareholder proposals that relate to corporate governance measures, including shareholder power to call a special meeting, executive compensation approval, and majority voting requirements.[49] A central critique of the application of this exclusion is that management will "displac[e] a strong rule 14a-8 proposal with a weak shadow of a company proposal on the same topic" merely to avoid including the original proposal.[50] This criticism refers to the timing advantage management has in employing this exclusion.[51]

Unlike in the Rule 14a-8(i)(10) context, management has a unique ability to manipulate the rules to its advantage in Rule 14a-8(i)(9) no-action requests and receive an SEC grant to exclude, especially with respect to numerical differences. This has most recently been evident in special meeting proposals, where company and shareholder proposal differences hinged on percentage variants.[52] The trend here

also CoBiz Fin. Inc., SEC No-Action Letter, 2009 WL 890003 (Mar. 25, 2009) (denying no-action request for exclusion of shareholder proposal for executive compensation annual approval, since it did not conflict with corporate proposal for current executive compensation approval).

[49] *See, e.g.*, Caterpillar Inc., SEC No-Action Letter, 2010 WL 411726 (Mar. 30, 2010); Gyrodyne Co. of Am. Inc., SEC No-Action Letter, 2005 WL 3198956 (Oct. 31, 2005); Walt Disney Co., SEC No-Action Letter, 2010 WL 4472797 (Dec. 27, 2010).

[50] Caterpillar Inc., SEC No-Action Letter, 2010 WL 411726, at *3 (Mar. 30, 2010).

[51] *See* discussion *supra* note 35.

[52] *See, e.g.*, Caterpillar Inc., SEC No-Action Letter, 2010 WL 411726 (Mar. 30, 2010) (excluding shareholder proposal for majority voting standard based on the number of votes cast since it conflicted with company proposal for voting standard based on number of outstanding shares); Express Scripts, Inc., SEC No-Action Letter, 2010 WL 5196311 (Jan. 31, 2011) (excluding shareholder proposal calling for 10% holding requirement to call a special meeting since it conflicted with company proposal calling for 35% holding requirement); Gyrodyne Co. of Am. Inc., SEC No-Action Letter, 2005 WL 3198956 (Oct. 31, 2005) (excluding shareholder proposal calling for 15% holding requirement to call for special meeting since it conflicted with company proposal calling for 30% holding requirement); H.J. Heinz Co., SEC No-Action Letter, 2007 WL 1245835 (Apr. 23, 2007) (excluding shareholder proposal calling for simple

has been companies having success in receiving no-action letters via a Rule 14a-8(i)(9) exclusion by advancing their own, more stringent proposals for minimum securities holding requirements. Shareholders receiving the proxy statement were only privy to the proposal favored by management, though the less stringent proposal may have been more in line with shareholder interests. The SEC has only addressed this timing advantage and denied a no-action request in the most egregious circumstances, when the company proposal was submitted "in response to . . . receipt of the [shareholder] proposal," and after that proposal had received a majority of votes.[53] In all other circumstances, the SEC has not inquired as to when management crafted its conflicting proposal.

It is evident how this could apply in the proxy access arena, since percentage thresholds will be a key component of the proposal details.[54] Based on established common law, "a company could avail itself of [the Rule 14a-8(i)(9)] exclusion by developing a company proposal relating to proxy access . . . and requesting no-action treatment to allow exclusion of the shareholder proposal."[55] Further,

majority vote because it conflicted with company proposal to lower supermajority voting standards to 60%); Int. Paper Co., SEC No-Action Letter, 2009 WL 772874 (Mar. 17, 2009) (excluding shareholder proposal calling for 10% holding requirement to call for special meeting since it conflicted with company proposal for 40% holding requirement).

[53] Genzyme Corp., SEC No-Action Letter, 2007 WL 869705, at *1–2 (Mar. 20, 2007).

[54] Numeric variants in proxy access proposals will likely involve number of years the securities have been held and the percentage of ownership to determine shareholder eligibility to include director nominations. *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56668-01 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249); *see also* JIM MCRITCHIE, U.S. PROXY EXCH., MODEL SHAREHOLDER PROPOSAL FOR PROXY ACCESS (2011), *available at* http://proxyexchange.org/standard_003.pdf; Bebchuk, *supra* note 11, at 871.

[55] Robert Morris, *Reacting to Shareholder Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Nov. 5, 2011, 9:08 AM),

"substantial differences between the shareholder's proposal and the company's proposal should not render the exclusion unavailable" in the proxy context, given that these differences will likely mimic the stark numerical variants sanctioned by the SEC for exclusion in the special meeting proposal context.[56] Applying Rule 14a-8(i)(9) common law and content to proxy access will allow the "company to define the terms of the proposal" and preempt any shareholder proposal "relating to this same topic."[57] Hence, companies can essentially circumvent the purpose of the Rule 14a-8 amendment and successfully prevent shareholder proposals from being incorporated into the proxy statement.

The SEC nearly ruled on this issue after Western Union used Rule 14a-8(i)(9) as an exclusion defense to a proxy access proposal, but the proposal was withdrawn before the staff could respond.[58] Although the SEC did not specifically rule on a Rule 14a-8(i)(9) exclusion no-action request, it has adhered to Rule 14a-8 common law throughout the 2012 proxy season. Based on the application of common law to the special meeting context, this would indicate that Rule 14a-8(i)(9) is fair game for companies to use to exclude meritorious proxy access proposals. Such a result is illogical and counterproductive to the SEC's intent in amending Rule 14a-8(i)(8). Under a proxy access structure that included a mandatory minimum via Rule 14a-11, conflicting percentage and threshold variants were likely expected to arise from shareholder proponents under the Rule 14a-8 "opt-in" procedure in the hope that if shareholders had a variety of choices, they would vote for the system most amenable to

http://blogs.law.harvard.edu/corpgov/2011/11/05/reacting-to-shareholder-proxy-access-proposals.

[56] *Id.*; *see also, e.g.*, Gyrodyne Co. of Am., SEC No-Action Letter, 2005 WL 3198956 (Oct. 31, 2005); Int. Paper Co., SEC No-Action Letter, 2009 WL 772874 (Mar. 17, 2009).

[57] *See* CADWALADER MEMO, *supra* note 37, at 4.

[58] Western Union Co., SEC No-Action Letter, 2012 WL 167225 (Feb. 21, 2012); *see also Western Union Plans to Declassify Board, Drops Proxy Plan*, DOW JONES NEWSWIRES, http://m.foxbusiness.com/quickPage.html?page=19453&content=66329693&pageNum=-1 (last visited Dec. 19, 2012).

their individual company.[59] The common law application of Rule 14a-8(i)(9) will lead to the opposite extreme, since management may prevent any shareholder-preferred proxy access model from appearing on the ballot via this mechanism. Allowing this reasoning to apply to proxy access endangers the very purpose of the SEC's amendment.

3. 14a-8(i)(12)

Rule 14a-8(i)(12) established a tiered system to allow exclusion if a proposal "deals with substantially the same subject matter as another proposal . . . previously included in the company's proxy materials within the preceding 5 calendar years," and did not solicit a target number of votes within a particular time frame.[60] The system is upward scaled, so that the more times the proposal has been submitted for vote, the higher the percentage required to salvage it from a present exclusion.[61] The exclusion is applicable as soon as the proposal fails to hit the target amount, regardless of a prior year's successful reach of the percentage threshold.[62] However, in order to apply the

[59] *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,673 ("[T]he net effect of our rules will be to expand shareholder choice, not limit it.").

[60] 17 C.F.R. § 240.14a-8(i)(12) (2012).

[61] Proposals may be excluded if they have received:

(i) Less than 3% of the vote if proposed once within the preceding 5 calendar years;

(ii) Less than 6% of the vote on its last submission to shareholders if proposed twice previously within the preceding 5 calendar years; or

(iii) Less than 10% of the vote on its last submission to shareholders if proposed three times or more previously within the preceding 5 calendar years.

Id.

[62] For example, if a proposal that is submitted for four consecutive years and is defined under the Rule as substantially similar receives on first submission over 3% of the vote, over 6% on second submission, over 10% on third, and over 6% but less than 10% on the fourth submission, it

exclusion, the proposal must have been formally presented for a shareholder vote, voted upon, and tabulated.[63] If the proposal is eligible for exclusion based on these grounds, then the company may exclude all proposals with "substantially the same subject matter" for the following three calendar years.[64]

The common law development and operation of Rule 14a-8(i)(12) render the exclusion's availability in the proxy access context questionable. First, in terms of applying the "substantially similar" terminology, all proxy access proposals (moving forward from the initial proposal) will be subject to exclusion; the substance is nearly identical, with each crafting a procedure by which shareholders may access the company's proxy statements to nominate director candidates. The differences between proposals will concern details such as percentage of ownership, years of ownership, or number of directors allowed for nomination—merely minutia under the wide-sweeping lens the SEC has previously applied to Rule 14a-8(i)(12) exclusion requests on the basis of substantial similarity. Second, the rationale behind the upwardly-scaled percentage requirements for avoiding exclusion is nonsensical in the proxy access proposal context. A proposal's attraction to an individual shareholder will depend heavily on the proposal's details. It is likely that it will take some time for shareholders to come to a consensus on the proxy access regime that best fits their corporation. Thus, not reaching a targeted percentage does not necessarily denote shareholder disinterest in this case.

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will be excludable in the fifth year because it failed to reach 10% in the fourth year. *Id.*

[63] Baldwin Piano and Organ Co., SEC No-Action Letter, 2000 WL 520641, at *1 (May 1, 2000) ("In this regard, we note that, because the previously included proposal was not formally presented for a shareholder vote, shares represented by proxies marked in favor of this proposal apparently were not voted for this proposal or tabulated. As there has been no tabulation of votes cast for the prior proposal, in our view that proposal did not receive a percentage of the vote that was 'less than 3% of the vote' within the meaning of rule 14a-8(i)(12)(i).").

[64] 17 C.F.R. § 240.14a-8(i)(12) (2012).

Rather, it indicates shareholder caution against committing to a less-than-desirable proxy access regime.

Again, manipulation is available here via the Rule 14a-8 mechanics. A forward-looking board may seek to incorporate a proxy access proposal unattractive to shareholders in one year's proxy materials, and use the failure to secure the sufficient amount of votes as ammunition for next year's exclusion. Under these constraints, shareholders are placed in a troublesome position. Either they doom proxy access for the three following years by refusing to vote for a proposal to which they object or believe needs refinement, or they vote for a proposal that they do not fully support. Given these probabilities, it is difficult to argue that the Rule 14a-8(i)(12) exclusion, as previously applied and interpreted by the SEC, operates productively toward the ultimate goal of providing shareholders with a viable avenue to establish a private ordering system.

B. Do Proxy Proposals Stand a Chance?

Rule 14a-8 has a long and extensive history, and its inception and common law were driven by different principles than the SEC's proxy access final rule.[65] The original rule and its exclusions were crafted in the same light as many federal securities laws, as a "disclosure-based framework to empower shareholders" by enabling investors to make informed decisions upon purchasing a company's securities.[66] Providing "an avenue for communication between shareholders and companies, as well as among shareholders themselves" was the target goal of the SEC in originally implementing Rule 14a-8; it was not increasing shareholder governance of internal corporate affairs.[67] After

[65] *See, e.g.*, Marc H. Folladori, *How to Prepare for the Upcoming Proxy Season: Shareholder Proposals*, 1855 PLI/CORP. 435 (2010).

[66] Jena Martin Amerson, *The SEC and Shareholder Empowerment—Analyzing the New Proxy Regime and Its Impact on Corporate Governance*, 30 No. 2 BANKING & FIN. SERVS. POL'Y REP. 8, 8 (2011).

[67] SEC Staff Legal Bulletin No. 14, 2001 WL 34886112 (July 13, 2001).

all, one of the Commission's chief concerns "was to relieve management of the necessity of including in its corporate proxy materials shareholder proposals relating to matters falling within the province of management."[68] The rule was thus developed with an interest of insulating management from shareholder proposals that would interfere with traditional corporate management functions and envisioned to apply to these types of ordinary-course proposals that were largely concentrated in topics of social responsibility.

This is specifically demonstrated in the construction and enforcement of Rule 14a-8(i), the principal management exclusion powers. The exclusion powers, which traverse procedural and substantive bases,[69] make sense when applied to shareholder social responsibility proposals that ultimately concern the ordinary affairs of the company. It is in this manner that the SEC allows management to perpetuate the continued separation of ownership and control that is well established in U.S. corporate law, while still promoting effective shareholder communication and dissemination of information. This explains why so many of the exclusions focus on conflict with management functions, company proposals, director elections, or relevance to operations. It also elucidates the SEC's tendency to grant no-action letters to management requests that involve operational rather than governance principles.[70]

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[68] Sean Patrick O'Brien, *The 1983 Amendments to SEC Rule 14a-8: Upsetting a Precarious Balance*, 19 VAL. U. L. REV. 221, 232 (1984).

[69] *See* 17 C.F.R. § 240.14a-8 (2012). On the procedural side, the SEC allows for company exclusion of shareholder proposals that are malapropos because they violate the law ((i)(1) and (i)(2)) or federal proxy rules ((i)(3)), are redundant with current bylaws ((i)(10) and (i)(11)), or enactment would exceed company authority ((i)(6)). Substantively, the rules exclude proposals based on the strength of their correlation to subject areas improper for shareholder proposals: these areas include "unrelevant" business ((i)(5)), management functions ((i)(7)), elections ((i)(8)), conflict with content of company proposals ((i)(9)) and frequency ((i)(12)). § 240.14a-8.

[70] A good example of this is in (i)(5) requests, where the SEC has granted no-action letters that relate to straightforward company business

If evaluated under a governance lens and applied to proxy access, however, the exclusion powers become illogical blockades against efforts of shareholder empowerment and board reform. Since the rule was established with a disclosure mindset rather than a governance one, the SEC was forced to craft new rules that would work not with, but around, the original disclosure-based structure. The Commissioner's goal, as stated in the final rule release, was to facilitate an increase in shareholder power and involvement in internal governance affairs.[71] However, inserting a corporate governance-geared amendment into a disclosure-based rule framework, without amending the other Rule 14a-8 exclusion bases or excepting the applicable common law, poses a conundrum for shareholders hoping to take advantage of proxy access.

One of the central arguments against a separate common law or exception rules for proxy access is that Rule 14a-8 has worked for other important governance measures in spite of its mechanical imperfections. In the special meeting and majority voting contexts, shareholders have been successful at implementing bylaws despite the inherent obstacles in Rule 14a-8 and pushback from management.[72] Management

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that is less than 5% of the total assets, net earnings, and gross sales, but created a caveat for corporate social reform proposals even when they involves less than 5% of company business. *Compare* College Retirement Equities Fund, SEC No-Action Letter, 2004 WL 1043801 (May 3, 2004) (excluding a proposal that CREF should warn its participants about consequences of reinsurance of the long-term care policies of TIAA-CREF because it was neither significantly related to the company's business nor a socially significant policy issue), *with* Caterpillar, Inc., SEC No-Action Letter, 2003 WL 105261 (Jan. 3, 2003) (refusing to exclude a proposal requesting that the board of directors report on the effect of the health pandemic on the company's operations in the Sub-Saharan Africa region and the company's response to such pandemic).

[71] *See* Amerson, *supra* note 66, at 9 (commenting on the SEC's move from disclosure-based rules to corporate governance via amendments to Rule 14a-8 and Rule 14a-11).

[72] Overall, 79% of S&P 500 firms have adopted a form of majority voting, and 51% provide shareholders with the right to call special meetings. *See* Ted Allen, *Apple Agrees to Adopt Majority Voting*, ISS

incentive to block these initiatives is similar to that in the proxy access context, since these specific proposals may also threaten the length of director terms. Therefore, proxy access, the argument goes, should work within the system in the same manner, and there is no need for additional protections to increase shareholder rights.

Yet proxy access differs from these examples in a few respects. First, the Commissioner has specifically indicated that proxy access should be treated differently, since "corporate governance is not merely a matter of private ordering. Rights, including shareholder rights, are artifacts of law . . . ."[73] The SEC's original goal was to concurrently enact the Rule 14a-8 amendment with a mandatory default rule under Rule 14a-11 to ensure that shareholders' rights to proxy access were not "bargained away but rather . . . imposed by statute."[74] Second, as previously noted, proxy access is inherently different from other bylaw proposals in its direct threat to incumbent management, as opposed to other bylaws, which pose a more generic imposition on management affairs. Finally, it should be noted that although special meeting and majority voting initiatives were ultimately implemented, they were not always in the form originally suggested by the shareholders.[75] In actuality, this evinces a broader issue with the Rule 14a-8 system's application to all governance initiatives that threaten directorship, including majority voting and special meetings. Perhaps if scrutinized, the appearance of management manipulation of exclusion rules in those

GOVERNANCE BLOG (Feb. 23, 2012, 5:03 PM), http://blog.issgovernance.com/gov/2012/02/apple-agrees-to-adopt-majority-voting.html; David Drake, *2011 Annual Corporate Governance Review*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Jan. 12, 2012, 9:28 AM), http://blogs.law.harvard.edu/corpgov/2012/01/12/2011-annual-corporate-governance-review.

[73] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,672 (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

[74] *Id.*

[75] *See supra* note 52.

contexts will further support the development of a separate common law for these kinds of governance proposals.

The main issue with the amalgamated format of Rule 14a-8 is that the SEC has changed the final image of the puzzle while only repainting a few of the pieces. It is attempting to accomplish a new objective of "facilitate[ing] shareholders' ability to nominate and elect directors," while operating in a partially revised framework of Rule 14a-8.[76] Further, the development of common law, focused on disclosure rather than corporate governance, is fairly applicable but inappropriate for accomplishing the SEC's goals at the time it passed the amendment.

The SEC's initiative to enhance shareholders' right to the ballot through proxy access will have been futile if Rule 14a-8 common law is applied in situations such as Rule 14a-8(i)(9) and Rule 14a-8(i)(12). The doctrines that evolved over time to establish that common law were based on a set of marginal decisions without foresight or intended application to the governance realm. The SEC made this clear in its final release by differentiating proxy access as a governance initiative that would require special action in order to successfully grant shareholders' right to nominate directors.[77] This intention became muddled, however, in the wake of *Business Roundtable* and in the absence of further guidance from the SEC upon entering the 2012 proxy season. In applying Rule 14a-8 common law to the "easy cases" in 2012, the SEC has unintentionally endangered the viability of proxy access within Rule 14a-8. Now, in order to ensure the sustainability of proxy access for shareholders, the Commissioner must take action prior to the next proxy season.

[76] *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668-01.

[77] *Id.*

IV. IMPLICATIONS AND POTENTIAL ACTIONS

Currently, the SEC sits in a powerful position with respect to the future sustenance of proxy access. Companies failed to turn to the more obviously supportive proxy access defenses based on Rule 14a-8 common law this year will undoubtedly follow the advisory consensus to use Rule 14a-8(i)(9) to exclude.[78] In response, the staff will make critical decisions in the next year. Without a sweeping policy standard or other guidance, staff members may mistakenly base these decisions on traditional Rule 14a-8 common law. This scenario is troubling, since the results of the staff's decisions will go against the SEC's ultimate objectives for shareholder facilitation of director nominations. If Rule 14a-8 is to give shareholders a meaningful opportunity to express their preferences on the rules governing shareholder access to the ballot, the SEC must recognize that its traditional approach in this area is not suitable for proxy access proposals and act accordingly.

Such action may take several forms. Preferably, the Commissioner can immediately issue a public interpretation release, clarifying that certain Rule 14a-8 bases will not be accepted as justifications for proxy access proposal exclusion, especially if the exclusions are deemed to be "manipulated." Another option is for the Commissioner to issue internal guidance to the staff instructing them to create a clear exemption for proxy access to Rule 14a-8(i)(9) and other inapplicable exclusions, which will publicly manifest in no-action letter denials. Finally, the staff may issue a ruling

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[78] *See* LATHAM & WATKINS LLP, PROXY ACCESS AND ADVANCE NOTICE BYLAWS IN THE WAKE OF INVALIDATION OF THE SEC'S PROXY ACCESS RULE: AN APPROACH TO PRIVATE ORDERING (2011), *available at* www.lw.com/upload/pubContent/_pdf/pub4437_1.pdf (hereinafter LATHAM MEMO); SULLIVAN & CROMWELL LLP, 2012 PROXY SEASON DEVELOPMENTS: SEC STAFF ISSUES LEGAL BULLETIN ON SHAREHOLDER PROPOSAL PROCESS; ISS RELEASES ITS 2012 DRAFT PROXY VOTING GUIDELINES ON SAY-ON-PAY, PAY-FOR-PERFORMANCE AND PROXY ACCESS (2011), *available at* www.sullcrom.com/2012-Proxy-Season-Developments (hereinafter S&C MEMO); CADWALADER MEMO, *supra* note 37, at 4–5.

indicating a priority for shareholder proposals over that of management-sponsored proposals if both are suggested for the ballot in the same year. Should the SEC fail to take such action, shareholders may still have hope in utilizing the traditional bylaw system to establish default rules that will take effect in situations of management manipulation of exclusion powers, although this will be a much harder course than the preceding suggestions.

A. Commissioner Issued Clarifying Release

From time to time, the SEC will issue clarifying interpretive releases in order to elucidate its policy for specific rules or provisions of law.[79] These releases may have different names,[80] but they accomplish the same goal: to indicate to investors and companies alike the staff's position on decision making under the described circumstances. For Rule 14a-8 alone, there has been substantial guidance through staff bulletins over the years to clarify issues or questions of the rule's application and the SEC Corporate Finance Division's policies or actions.[81] On the issue of proxy access, the staff would be wise to use this mechanism in order to clarify how it will rule on proxy access no-action requests based on "manipulated" exclusions.

The content of the legal bulletin need not be extensive. The Commissioner simply should reiterate the central objectives delineated in the original proxy access ruling and describe how application and acceptance of certain exclusions work against these goals. In light of this, the bulletin can explain that it will be staff policy to deny no-action requests that invoke these exclusions when the circumstances evince "corporate manipulation" of the

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[79] *See* Div. of Corp. Fin., SEC, *No-Action, Interpretive and Exemptive Letters*, www.sec.gov/divisions/corpfin/cf-noaction.shtml (last modified Nov. 30, 2012).

[80] *See, e.g., Div. of Corp. Fin.*, SEC, *Staff Guidance and Interpretation*, www.sec.gov/divisions/corpfin.shtml (last modified Oct. 11, 2012).

[81] *See* SEC *Staff Legal Bulletins*, www.sec.gov/interps/legal.shtml (last modified Oct. 11, 2012).

systematic advantages inherent in Rule 14a-8. Corporate manipulation might have an evolving definition based on the past and on future cases, but it should certainly include management's efforts to take advantage of the time gap between shareholder submission of the proposal and a no-action request.

Initiating a legal bulletin on this matter will serve the SEC, shareholders, and corporations well. It will reinvigorate the operational capability of Rule 14a-8 for proxy access proposals, since it will deter companies from unfairly excluding shareholder proposals based on mechanical blips. If released before the next proxy season, it will diminish a probable influx of Rule 14a-8(i)(9) no-action letter requests to the SEC, allowing the SEC to shift focus to other pressing policy matters. On a governance level, this action would encourage management to take serious consideration of shareholder proposals and provide for increased accountability of the board of directors. In short, it would remedy the faults of the current system and confirm that the SEC's policy is as it originally intended: to facilitate shareholder director nominees and enhance available corporate governance mechanisms.

B. Internal Staff Guidance

Should the SEC wish to take a more back-ended approach in an attempt to avoid additional public scrutiny on this issue, it can simply provide clear and precise guidance to its staff members explaining how to rule effectively on these kinds of no-action requests. This internal guidance would act as a SEC-wide policy, so that it is uniformly applied across all cases. Its content would be similar or identical to the public release described above, indicating the specific exclusion rules that seem inappropriate for proxy access proposals, and declaring a policy to deny no-action requests that are based on these exclusions and evidence "corporate manipulation."

The net effect of this kind of action would be similar to that of a public release. Eventually, the norm would be a

new common law development for proxy access within Rule 14a-8 that does not include the more inappropriate exclusion bases. In fact, the development of proxy access proposals under Rule 14a-8 would be more accurate and robust through this method, since the SEC would respond to matters on a case-by-case basis.[82] The timeline, however, would be considerably longer and would depend on the volume of no-action letters received by the SEC. Furthermore, since the guidance would be non-public until after the staff began to respond to the no-action letters, there would be an initial degree of uncertainty that may influence shareholders to be overly cautious and cooperative in the next proxy season. Shareholders who submit proposals but see substantial risk of successful exclusion based on Rule 14a-8(i)(9) may feel pressured to negotiate with management at the threat of a no-action request. This kind of ex-post action may result, then, in the de facto death of proxy access before the SEC has a chance to weigh in.

C. Rulemaking for Shareholder Proposal Priority

A more aggressive method would be for the SEC to create another ruling that provides procedural instructions in the event that management and shareholder proxy access proposals conflict. This ruling would override and replace the common law surrounding Rule 14a-8(i)(9) for the purposes of proxy access proposals. In order to adhere to the original principles of the shareholder proxy access amendment, such a ruling would place priority on shareholder proposals in situations where these proposals conflict with those of management. An unconstrained priority would be dangerous, however, given that retail shareholders might suggest unrealistic and inefficient regimes. This would be just as counterproductive as an overly harsh management regime. The key is to arrive at

[82] This would be similar to how the common law for other Rule 14a-8 rulings has developed. *See* sources cited *supra* note 48 (no-action letters defining what constitutes a "conflicting" proposal under Rule 14a-8(i)(9)).

the middle of these two extremes, which is certainly possible with a priority ruling, as long as the SEC sets reasonable boundaries. These restraints may be situational, such as allowing for shareholder priority only if the management rule is constructed and proposed in that interim time gap. They may also be numerical; the priority rule might only take effect if the management proposal thresholds are in excess of the shareholder's by a given percentage.

Although a ruling would be a more concrete way of resolving the issues with Rule 14a-8 exclusions, it is not the most efficient. As with the internal guidance, the timeline for such a rule to take effect would be long, not to mention the red tape and scrutiny that is unavoidable for administrative rulemaking after the D.C. Circuit's decision. Furthermore, since the SEC is already behind in its rulemaking procedures for those rules mandated by Dodd-Frank, it is highly unlikely that the SEC will initiate a ruling for proxy access in the shadow of these other legal mandates.

D. Shareholder Action

Theoretically, shareholders may have recourse through their own means of action even if the SEC does not take any of the above initiatives. Ironically, shareholders could use the Rule 14a-8 system to guard against its common law by proposing a bylaw that establishes a default rule in situations where there is evidence of management manipulation of exclusion powers. This default rule could be similar to the shareholder priority ruling suggested above. There are several reasons why this would not be the optimal solution. First, although shareholders would not have to worry about the same types of exclusion powers as in the proxy access context, there are other exclusions that management may invoke and successfully argue, including

the "ordinary business" exclusion.[83] Second, even if no exclusion is invoked, such a proposal would likely be precatory, not binding. This again places ultimate decision-making authority with the board, which presumably would not implement such an affronting initiative regardless of whether there were a supporting majority shareholder vote. Finally, this type of initiative has minimal effect unless successful. Granted, the appearance of such a proposal may make management think twice about the satisfaction of their shareholders and the issues within corporate operations that led to this accountability initiative. However, this does not guarantee governance reform. Rather, there is more likely to be a greater certainty of corporate response to these governance proposals if the SEC takes action to insulate proxy access from the inappropriate provisions of Rule 14a-8 common law.

V. CONCLUSION

The 2012 proxy season illuminated the importance of the Rule 14a-8 framework to accomplishing true shareholder proxy access via private ordering, and it highlighted for shareholders, management, and the SEC areas of success as well as areas that need improvement. It was clear by the end of this season that proxy access cannot live peaceably within Rule 14a-8 and its common law as currently constructed. There remain issues, the most pressing of which is the interpretation of Rule 14a-8(i)(9), which must be resolved in a timely manner by the SEC in order to perfect the private ordering system. Should the SEC fail to act accordingly, the entire Rule 14a-8 system will be compromised in its application to proxy access and serve only to aid in the slow and eventual demise of shareholder-sponsored proxy access proposals. Only after effective action by the Commissioner and staff will shareholders and

[83] 17 C.F.R. § 240.14a-8(i)(7) (2012) (permitting exclusion for "[m]anagement functions . . . [for proposals dealing] with a matter relating to the company's ordinary business obligations").

investors be able to utilize the proxy access private ordering system with confidence in the way it was originally intended, as a mechanism for corporate governance and director accountability.