Milbank

Client Alert

SEC Declines to Provide Guidance on Shareholder Proxy Access Proposals Prior to 2007 Proxy Season

On January 22, 2007, the Staff of the Securities and Exchange Commission expressed "no view" in its highly anticipated response to Hewlett-Packard Co.'s request to exclude a shareholder proxy access proposal from its 2007 proxy statement. The proposal, submitted by the American Federation of State, County and Municipal Employees (AFSCME) and other pension funds, was the first shareholder proposal seeking access to a company's proxy materials for shareholder nominations of director candidates following the September 2006 decision of the U.S. Court of Appeals for the Second Circuit in *American Federation of State, County and Municipal Employees v. American International Group, Inc.* (*AFSCME v. AIG*).[1] Like the shareholder proposal at the heart of the dispute in *AFSCME v. AIG*, the HP shareholder proposal seeks to amend HP's bylaws to require the company to include the names of director candidates nominated by certain shareholders in its annual meeting proxy materials.

In connection with the SEC's response to HP, SEC Chairman Christopher Cox issued a public statement that "[t]he SEC staff quite properly are following Commission precedent, expressing no view as to the eventual disposition of what is for the moment an unsettled legal question."[2] Chairman Cox also indicated that the SEC would delay consideration of a response to *AFSCME v. AIG*.

The unsettled legal question referenced by Chairman Cox arises out of the Court's ruling in *AFSCME v. AIG* regarding Rule 14a-8(i)(8) under the Securities Exchange Act of 1934. Rule 14a-8(i)(8), one of several exceptions to the general rule that a company must include properly-presented shareholder proposals in its proxy materials, provides that a shareholder proposal that "relates to an election for membership on a company's board of directors" may be excluded. In *AFSCME v. AIG*, AIG argued that AFSCME's proxy access proposal was properly excludable under Rule 14a-8(i)(8) because it related to an election of directors. AFSCME took a narrower view, arguing that since its proposed bylaw amendment did not affect any *particular* election, but instead addressed only the procedures generally governing *all* elections, the proposal was not excludable. The SEC, which had granted "no action" relief to AIG with respect to excluding the AFSCME proposal, filed an *amicus* brief stating its view that Rule 14a-8(i)(8) applied to bylaw amendments (such as AFSCME's) that

[1] 2006 WL 2557941 (2d. Cir. Sept. 5, 2006).
[2] *See* Judith Burns, *SEC Staff Takes No Position On H-P Proxy Vote*, Jan. 22, 2007, available at http://money.cnn.com/news/newsfeeds/articles/djf500/200701221610DOWJONESDJONLINE000529_FORTUNE5.htm.

would provide shareholders with access to company proxy materials for the nomination of candidates in director elections.[3]

The Second Circuit concluded that the wording of the Rule was ambiguous, and found that the SEC's past guidance on the Rule — which, according to the Court, was limited to only allowing exclusions of shareholder proposals that would result in an *immediate election contest* — directly conflicted with the SEC's position in its *amicus* brief. According to the Court, since the SEC had not explained this change in its position either in the *amicus* brief or prior to granting "no action" relief to AIG, it was appropriate for the Court to defer to its own interpretation of the SEC's prior guidance. On this basis, the Court ruled in favor of AFSCME.

In the wake of this ruling, the SEC announced that it would consider amending Rule 14a-8 to address the Second Circuit's decision, and expected to have a final rule available in advance of the 2007 proxy season. Since that announcement, however, the SEC apparently has found it difficult to resolve the issue, twice deferring consideration of the issue at Commission meetings held prior to Chairman Cox's January 22 statement.

As long as the SEC continues to defer a decision regarding its response to *AFSCME v. AIG*, companies can only assume that (i) activist shareholders will continue to file similar shareholder proxy access proposals (although in most cases it is too late for shareholders to submit proposals for inclusion in 2007 annual meeting proxy statements) and (ii) the SEC will continue to refuse "no action" relief for excluding such proposals.[4] Companies located outside of the Second Circuit (which includes New York, Vermont and Connecticut) may try to take the position that *AFSCME v. AIG* does not apply outside the jurisdictional purview of the Second Circuit. However, in light of the uncertainty, it seems more likely that companies will conclude that it is not worth the effort – and potentially adverse investor reaction – to try to exclude shareholder proxy access proposals. HP, for example, included AFSCME's proposal in its definitive proxy statement shortly after receiving the SEC's "no view" response.

The confusion over the interpretation of Rule 14a-8(i)(8) recalls the controversy surrounding the SEC's proposed Rule 14a-11 which, when introduced for comment in October 2003, was sharply criticized by both proponents and opponents of shareholder proxy access. The proposed rule would have required companies, under certain circumstances, to include in their proxy statements a limited number of director candidates nominated by certain

[3] The SEC's view was consistent with the positions the SEC took in several recent "no action" letters issued after the demise of proposed Rule 14a-11. *See, e.g.*, The Walt Disney Company, SEC No Action Letter (Dec. 28, 2004); Qwest Communications International Inc., SEC No Action Letter (Feb. 7, 2005); Verizon Communications Inc., SEC No Action Letter (Feb. 7, 2005); and Halliburton Company, SEC No Action Letter (Feb. 7, 2005). We described these "no action" letters in our Client Alerts entitled "SEC Allows Disney to Exclude Shareholder Proposal Seeking Right to Include Shareholder Nominees on Company's Proxy" dated February 7, 2005 and "Update: SEC Again Allows Companies to Exclude Shareholder Direct Access Proposals" dated February 16, 2005.

[4] At this point in the 2007 proxy season, at least two other companies have requested "no action" relief in connection with excluding shareholder proxy access proposals. *See* Burns, *supra* note 2. In addition, Reliant Energy Inc. has filed a federal lawsuit in the Southern District of Texas seeking declaratory relief that a proposal submitted by Seneca Capital, L.P., a hedge fund, is properly excludable under Rule 14a-8.

shareholders.[5] The intensity of the public debate, as well as the sharp division among the SEC Commissioners and Staff members over the proposed rule, caused the SEC to postpone adoption of Rule 14a-11 indefinitely. However, activist shareholder attempts to gain access to Company proxy materials for their director candidates through Rule 14a-8 shareholder proposals could very well bring the subject of shareholder proxy access back to the forefront, and may even encourage the SEC to revive the proposed rule in some form.

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[5] For further discussion of proposed Rule 14a-11, *see* our Client Alert entitled "SEC Proposes Rules Enabling Shareholders to Include Nominees in Company Proxy Materials" dated October 24, 2003. AFSCME's HP proposal appears modeled after some aspects of the Rule 14a-11 approach.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

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In addition, if you would like copies of our other Client Alerts, the SEC's response to HP's "no-action" request or any of the "no-action" letters cited herein, please contact any of the attorneys listed above. You can also obtain this and our other Client Alerts by visiting our website at http://www.milbank.com and choosing the "Client Alerts & Newsletters" link under "Newsroom / Events".

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