

January 2, 2008

## SEC Affirms Interpretation of Shareholder Proposals Rule Relating to the Election of Directors

On December 6, 2007, the Securities and Exchange Commission (the "SEC"), affirmed its long-standing interpretation of Rule 14a-8(i)(8) under the Securities Exchange Act of 1934, as amended. This rule permits companies to exclude from their proxy materials shareholder proposals that relate to the election of directors. The recent case of *AFSCME v. AIG*<sup>1</sup> cast doubt on this interpretation, and in July 2007 the SEC put forth two alternative proposals of this "shareholder access" rule. The first proposal affirmed the SEC's historical interpretation while the second proposal would have required companies, under certain circumstances, to include in their proxy materials proposals for binding bylaw amendments establishing a procedure by which shareholders can nominate candidates to the board of directors.

The amended rule, which will become effective on January 10, 2008, permits the exclusion of proposals that relate to the election of directors or to a *procedure* for the election of directors. In his statement at the SEC's open meeting on November 28, 2007, Chairman Cox indicated that the SEC is adopting this amendment in order to provide clarity for the 2008 proxy season. However, the SEC intends to keep the issue of shareholder access at the forefront with the hope of coming to unanimous agreement on some form of shareholder access in the near future.

### Background

Rule 14a-8 currently requires companies to include in their proxy materials proposals presented by shareholders unless the proposal does not fit within one of the substantive categories of the rule or unless the shareholder has failed to meet the procedural requirements of the rule. There are 13 substantive categories of proposals which may be excluded, including Rule 14a-8(i)(8), which permits a company to exclude a proposal if it "relates to an election for membership on the company's board of directors or analogous governing body."

Historically, the SEC has interpreted Rule 14a-8(i)(8) to allow exclusion of shareholder access proposals. In the *AFSCME* case, however, the U.S. Court of Appeals for the Second Circuit held that Rule 14a-8 did not allow AIG to exclude a proposal to amend the company's bylaws to require inclusion of shareholder-nominated director candidates in its proxy materials. The Court reasoned that although Rule 14a-8 permits a company to exclude shareholder proposals that relate to a particular election, *AFSCME*'s proposal related to rules governing elections generally; it merely set mechanics in place for possible contested elections in future years, but did not immediately lead to a contested election. Therefore, AIG could not properly exclude the proposal pursuant to Rule 14a-8.

Although the *AFSCME* case affected only companies in the Second Circuit, it had broader repercussions. In June 2007, the Supreme Court overturned a Second Circuit case on grounds that an agency's interpretation of its own rules is controlling, adding to the confusion surrounding the *AFSCME* case.<sup>2</sup> During the 2007 proxy season, the SEC expressed "no view" in response to several shareholder access

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<sup>1</sup> 462 F.3d 121 (2nd Cir. 2006).

<sup>2</sup> See *Long Island Care at Home, Ltd. V. Coke*, 551 U. S. \_\_\_\_ (2007) (slip op.).

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proposals, and a number of these proposals won significant support at some of the meetings. In order to address this issue, the SEC held a series of roundtable discussions about the federal proxy rules in May 2007 and proposed alternative proposals in July 2007. In December 2007, the SEC finally reaffirmed its interpretation by amending the rule to permit a company to exclude a proposal that “relates to a nomination or an election for membership on the company’s board of directors or analogous governing body or a procedure for such nomination or election.”

## Text of Releases

The final rule release may be found on the SEC’s website using the following link: <http://www.sec.gov/rules/final/2007/34-56914.pdf>. The items summarized above are only a few of the specific issues addressed by the release. We urge you to read the releases in their entirety and contact any of the individuals listed below if you have questions on any of the items. If the proposed rules are adopted, we will supplement this legal alert to describe the final rules and any important transition dates.



This legal alert was prepared by Sutherland Asbill and Brennan LLP’s Securities/ Corporate Governance practice group. If you have any questions or would like additional information, please contact the Sutherland attorney with whom you work.

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