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**Final Rule: SEC's Amendments to Regulation 14A Codifying
the SEC's Current Position on Bylaw Proposals Requiring the Inclusion
of Shareholder Nominees and Concerning Electronic Shareholder Forums**

On November 28, 2007, the Securities and Exchange Commission ("SEC" or "Commission") at an open meeting, voted to adopt sections of two proposals made on July 25, 2007.¹ One vote adopted a proposed amendment to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"),² which permits a company to exclude from its proxy statement any shareholder proposal seeking to amend company bylaws to require the company to list shareholder-nominated candidates for the board of directors on the corporate ballot (the "Exclusion Rule"). The new provision permits such exclusion on the ground that such a proposal "relates to an election" under Exchange Act Rule 14a-8(i)(8). Another vote adopted a proposed rule³ (the "Shareholder Forum Rule") that would expand paragraph (b) of Rule 14a-2 under the Exchange Act, to allow an exemption from the proxy rules of solicitations made within an "electronic shareholder forum" more than 60 days prior to a shareholder meeting by persons who are not soliciting proxies, and would exempt persons who establish, maintain or operate such forums from liability under the federal securities laws for any statement made by another person on such a forum.

¹ See Speech by SEC Chairman: Opening Remarks at the SEC Open Meeting by Chairman Christopher Cox, U.S. Securities and Exchange Commission, Washington, D.C. November 28, 2007, <http://www.sec.gov/news/speech/2007/spch112807cc.htm>. The text of the SEC staff's presentation of these two releases may be found at <http://www.sec.gov/news/speech/2007/spch112807tb.htm> and <http://www.sec.gov/news/speech/2007/spch112807lcb.htm>. Video footage of the respective presentations at the meeting are archived at http://www.sec.gov/news/speech/2007/video112807_forums.wmv or http://www.sec.gov/news/speech/2007/video112807_directors.wmv and at http://www.sec.gov/news/speech/2007/video112807_directors.mov.

² See SEC Release No. 34-56161; IC-27914; File No. S7-17-07, *Shareholder Proposals Relating to the Election of Directors* available at <http://www.sec.gov/rules/proposed/2007/34-56161.pdf>.

³ See SEC Release No. 34-56160; IC-27913; File No. S7-16-07, *Shareholder Proposals* (July 27, 2007) available at <http://www.sec.gov/rules/proposed/2007/34-56160.pdf>.

The Exclusion Rule was adopted by a vote of 3-1, with Chairman Cox and Commissioners Atkins and Casey voting in favor and Commissioner Nazareth voting against. The Shareholder Forum Rule was adopted by a unanimous vote of the four Commissioners.⁴ The final Exclusion Rule was released on December 6, 2007.⁵ The final Shareholder Forum Rule has not yet been released.

The Shareholder Forum Rule was originally proposed in the same release as a provision that would have replaced the SEC's interpretation of Rule 14a-8 concerning the shareholder bylaw proposals described below with a rule specifying that such a proposal could not be excluded, provided it was a binding proposal made by a holder of 5% of the company's stock. This part of the original rule proposal (the "Increasing Shareholder Access Proposal") was omitted from the rule adopted in favor of the Exclusion Rule, which had been separately proposed as an alternative to the Increasing Shareholder Access Proposal.

The adoption of the Exclusion Rule resolved what had become an open question concerning Rule 14a-8. In September 2006, the Second Circuit invalidated the SEC's interpretation that a shareholder proposal to adopt bylaws requiring a company to include certain shareholder-nominated candidates for the board of directors on the corporate ballot can be omitted⁶ as described above. This opinion created uncertainty as to whether the SEC's interpretation would remain valid in other circuits. Adoption of the Exclusion Rule effectively overturns this court ruling and affirms the SEC's interpretation that was in effect prior to the court ruling.

I. Bylaw Proposals Concerning Director Elections under Rule 14a-8

Adoption of the Exclusion Rule codifies the SEC's current interpretation of Rule 14a-8(i)(8) regarding proposals that relate to an election of directors. Under that interpretation, companies may exclude from their proxy materials proposals that would (1) result in an immediate election contest, or (2) set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings.

Having voted in favor of proposals both of this rule, which allows for the exclusion of bylaw proposals described above, and of the Inclusion Proposal, Chairman Cox, by way of explaining his vote, described the rule adopted as the "only one that, at this critical juncture as we enter the proxy season, can command the three votes needed to become final." He explained that the point of this rulemaking was to avoid a situation where there would be "no clear and authoritative interpretation of [the Commission's] rules" and to ensure that the required material disclosures and antifraud rules in proxy contests could not be circumvented. He noted that the proposal to be adopted would result in "absolutely no change in the way the rule has been applied for the last 17 years."

⁴ Commissioner Roel Campos resigned and left the Commission in mid-September, 2007.

⁵ See SEC Release No. 34-56914; IC-28075; File No.: S7-17-07, *Shareholder Proposals Relating to the Election of Directors*, available at <http://www.sec.gov/rules/final/2007/34-56914.pdf>.

⁶ See *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006) ("AFSCME v. AIG").

However, Chairman Cox also stated that “merely preserving the status quo is not what many investors hope for — and I include myself in that camp.” He stated that he had hoped that the decision in *AFSCME v. AIG* would provide an opportunity to revise the proxy rules to vindicate shareholder rights, and that some investors hoped that the Commission would withhold any ruling that would overturn *AFSCME* while there existed a vacancy on the Commission. Commissioner Campos, who resigned shortly after the Inclusion Proposal was voted into effect, had represented the third vote in favor of reconsidering the Commission’s interpretation. However, the Chairman stated that to withhold any ruling would “put investors at risk,” and therefore the Commission had to act. Chairman Cox stated that but for that concern, he might have been inclined to delay a final vote until a full panel of Commissioners had been appointed.

In explaining his concern about the present uncertain situation, the Chairman noted that even at the Commission there was significant disagreement as to what Rule 14a-8 meant after *AFSCME v. AIG* and the Supreme Court’s ruling in *Long Island Care at Home, Ltd. v. Coke*,⁷ which overturned a decision of the Second Circuit on grounds that could have applied to the *AFSCME* case. The Chairman concluded that “to permit this state of affairs to continue for the 2008 proxy season and possibly beyond would effectively require shareholders and companies to go to court to determine the meaning of the Commission’s proxy rules” and that “to replace the rule of law with deliberate vagueness and uncertainty” would be detrimental to all shareholders.

In explaining his concern over fraud, the Chairman noted that if the *AFSCME* decision were applied without any new SEC rule to make sense of it, a bylaw could be proposed by a malicious person seeking to replace the board and loot a company, with no meaningful disclosure about who made the proposal or why (other than name, address, and number of shares). Furthermore, “even if all of the disclosures that were made were intentionally and materially false and misleading, there would be a serious question whether our existing Rule 14a-9, the antifraud rule, would apply,” since 14a-9 is directed to a person conducting a proxy solicitation, which is in this case the company, whose proxy statement the proposer is being allowed to access. Thus, in this case, shareholders would have no knowledge of the background and designs of the proposer, and this would represent a breakdown in the proxy system and expose shareholders to harm. The Chairman described this scenario as “all too easy to contemplate.”

The Chairman ended his remarks by noting that the Second Circuit’s decision has focused the attention of the Commission and investors on the issues at hand, and stating that “[the Commission] will not lose that momentum in the coming year.” He stated that as Chairman he would “continue to work to strengthen the proxy rules to better vindicate the fundamental state law rights of shareholders” and stated that “[it is] of the utmost importance that the most fundamental and ironclad legal right that a shareholder has — the right to choose the company’s directors — is jealously guarded by our legal system.” He concluded by noting that the two competing proposals had received a total of 34,000 public comments, and that investors should note both the significant accomplishments that the Commission has already made under his tenure, and the consensus-building that the Commission has tried to effect in that time.

⁷ *Long Island Care at Home, Ltd. v. Coke*, ___ U.S. ___, 127 S. Ct. 2339 (2007).

II. The New Rules Concerning Electronic Shareholder Forums

The new rules concerning electronic shareholder forums exempt from most of the proxy rules solicitations by a company or its shareholders (or any person acting on behalf of the company or shareholders) that are made on an electronic shareholder forum, so long as:

(1) the person making the solicitation does not seek directly or indirectly, on its own or on behalf of another, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization, and

(2) the solicitation is made more than 60 days prior to the date announced by a company for its next annual or special meeting of shareholders, or if the company announces the date of its next annual or special meeting of shareholders less than 60 days before the meeting date, then the solicitation may not be made more than two days following the date of the company's announcement of the meeting date.

The new rules also provide that reliance on the above exemption does not eliminate a person's eligibility to solicit proxies after the final date that the above exemption is available, provided that any such solicitation is conducted in accordance with Regulation 14A. The exemption described above was originally proposed under a new paragraph (b)(6) to Rule 14a-2.

New Rule 14a-17 provides that no company or shareholder (or third party acting on a company or shareholder's behalf) that establishes, maintains or operates an electronic shareholder forum will be liable under the federal securities laws for any statement or information provided by another person via the electronic shareholder forum.

The Chairman stated that the purpose of the new rules is to allow electronic shareholder forum communications to supplement the shareholder proposal process, providing "cheaper, faster and better" ways to engage each other and the company. In order to do so, the new rules address concerns of investors and companies that communications expressed through such forums might be considered proxy solicitations, and that an investors or companies might incur vicarious fraud liability for the statements of others by operating such forums. The Chairman stated that the goal of the new rules is to encourage experimentation in the area of electronic shareholder forums, and that the ultimate hope is that these forums may in the future provide a mechanism to vindicate shareholder rights more cheaply and effectively by supplementing the proxy process.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jon Mark at (212) 701-3100 or jmark@cahill.com; John Schuster at (212) 701-3323 or jschuster@cahill.com; or Arthur Dobelis at (212) 701-3359 or adobelis@cahill.com.