HUNTON& WILLIAMS

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SEC Adopts Amendment to Proxy Rules; Confirms Its Position That Companies May Exclude Shareholder Proposals Relating to Board Elections from Their Proxy Materials

At its November 28, 2007 open meeting, the Securities and Exchange Commission (the "SEC") voted three to one to adopt a proposed amendment to Rule 14a-8(i)(8)[1] under the Securities Exchange Act of 1934 to confirm its long-standing interpretation that a company may exclude from its proxy materials shareholder proposals relating to an election for membership on the company's board of directors. The SEC adopted the amendment substantially as it had been proposed.[2]

Rule 14a-8(i)(8) sets forth one of several substantive bases upon which a company may rely to exclude a shareholder proposal from its proxy materials. Prior to the amendment, Rule 14a-8(i)(8) provided that a company need not include a proposal in its proxy materials "[i]f the proposal relates to an election for membership on the company's board of directors or analogous governing body."

In its application of Rule 14a-8(i)(8), the SEC staff historically permitted companies to exclude any shareholder proposal that might result in a contested election at the immediate or any future shareholder meeting, reasoning that Rule 14a-8 is not the proper means for conducting director election campaigns.[3] Rather, as the staff noted, other proxy rules, which have been carefully crafted to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in contested elections, are applicable.

The SEC's long-standing interpretation of Rule 14a-8(i)(8), however, was called into question in *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*,[4] which involved a shareholder proposal in the form of a bylaw amendment to permit large, long-term shareholders access to AIG's proxy materials in subsequent years for the purpose of nominating director candidates. AIG excluded the proposal under 14a-8(i)(8) on the basis that it related to an election of the board of directors. The Second Circuit held that the proposal was not properly excludable under Rule 14a-8(i)(8) because it did not relate to a specific election, but to procedures for elections generally. The Second Circuit held that the SEC's current interpretation was inconsistent with the earlier adoption of Rule 14a-8(i)(8) and that the SEC must formally adopt, via the notice and comment procedures, its current interpretation if it disagreed with the Court.

[1] The amendment will become effective 30 days after its publication in the Federal Register.
[2] See Exchange Act Proposing Release No. 34-56161 (June 27, 2007) available at http://www.sec.gov/rules/proposed/2007/34-56161.pdf (the "June 27 Release"). The final adopting release is not yet available but is expected to be posted on the SEC's website soon; however the SEC press release regarding the amendment is available at http://www.sec.gov/news/press/2007/2007-246.htm.
[3] The staff has expressed the position that a proposal may result in a contested election if it is a means either to campaign for or against a director nominee or to require a company to include shareholder-nominated candidates in the company's proxy materials.
[4] 462 F.3d 121 (2d Cir. 2006).

The amendment adopted by the SEC responds to the uncertainty and confusion with respect to the appropriate application of Rule 14a-8(i)(8) following the Second Circuit's decision in *AIG* and clarifies the SEC's position that shareholder proposals on proxy statement access for board nominations are excludable pursuant to Rule 14a-8(i)(8) if the proposal (1) would result in an immediate election contest (e.g., by making or opposing a director nomination for a particular meeting) or (2) would 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.[5]

As amended, Rule 14a-8(i)(8) will now provide that a company may exclude a shareholder proposal:

> [i]f the proposal 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*.

The battle over shareholder access to company proxy materials may not be over: SEC Chairman Cox noted at the November 28 meeting that the adoption of the amendment was not meant to circumvent or prevent further discussion, analysis or SEC action in the area of shareholder access to company proxy materials.

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[5] The June 27 Release lists certain shareholder proposals that may not be excluded, including proposals related to:

- qualifications of directors or board structure (as long as the proposal will not remove current directors or not disqualify current nominees);
- voting procedures (such as majority or cumulative voting); and
- reimbursement of shareholder expenses in contested elections.