

The Proxy Rules and Restrictions on Shareholder Voting Rights

*J. Robert Brown, Jr. **

I. INTRODUCTION.....	45
II. THE ANNUAL MEETING PROCESS	48
A. State Law Requirements	49
B. Shareholder Proposals and the Proxy Rules.....	51
III. SHAREHOLDER VOTING RIGHTS AND THE PROXY CARD	52
A. Partially Completed Proxy Cards	54
B. Discretionary Authority	56
1. Rule 14a-4(c)(1): “Unexpected” Matters	56
2. Rule 14a-4(c)(6): Proposals “Omitted” under Rule 14a-8.....	59
3. Rule 14a-4(c)(2): “Non-Rule 14a-8 Proposals”	62
IV. PREVENTING THE EXERCISE OF DISCRETIONARY AUTHORITY ..	68
V. THE LIMITATIONS IMPOSED ON SHAREHOLDERS: A CASE STUDY	71
A. Auditor Qualifications	71
B. Auditor Ratification	75
VI. ANALYSIS.....	77
VII. CONCLUSION.....	82

I. INTRODUCTION

Shareholders in public companies vote not by attending the meeting but by exercising their rights under the federal proxy rules.¹

* Professor of Law, Director, Corporate & Commercial Law Program, University of Denver Sturm College of Law.

¹ See Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1142 (1993) (“It seems to me that the heart of the problem lies in the failure of corporate practice to reproduce through the proxy medium an annual meeting substantially equivalent to the old meeting in person. I know that the old-fashioned meeting cannot be revived. Admittedly, that is impossible. It is not impossible, however, to utilize the proxy machinery to approximate the conditions of the old-fashioned meeting.”) (quoting Robert H. O’Brien, SEC Comm’r, Address Before the Conference Board 3 (Jan. 21, 1943)); see generally Robert B. Thompson, *Delaware, the Feds, and the Stock Exchange: Challenges to the First State as First in Corporate*

Recognizing this,² the U.S. Securities and Exchange Commission (“the Commission” or “SEC”) has at times described the proxy rules as neutral in effect, designed only to provide shareholders with the same rights accorded under state law.³ In fact, this has often not been the case. Over their eighty-year development, the rules have often reduced rather than complemented the rights otherwise available to shareholders at these meetings.

This can be seen with particular clarity in connection with the erosion of shareholder voting rights. Under the proxy rules, Rule 14a-8 permits shareholders to submit a proposal for inclusion in the proxy statement.⁴ The rule contains procedural conditions and substantive restrictions that allow for the exclusion of some proposals. Shareholders seeking to avoid these limitations may either distribute their own proxy statement, an often prohibitively expensive step, or, under state law, wait for the meeting and make the proposal there.⁵

To the extent that shareholders opt for the latter approach, the proxy rules all but guarantee that the effort will fail. Upon execution of a proxy card, Rule 14a-4 allows for the involuntary transfer to

Law, 29 DEL. J. CORP. L. 779 (2004).

² See U.S. SECS. & EXCH. COMM’N, 77TH CONG., REPORT ON PROPOSALS FOR AMENDMENT TO THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, PRINTED FOR THE USE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE 35 (Comm. Print 1941) (“Since ownership of securities . . . is today effected almost entirely by proxies, the provisions of Section 14 are of paramount importance.”).

³ See *Hearings on H.R. 1493, H.R. 1821 and H.R. 2019 Before the H. Comm. on Interstate and Foreign Commerce*, 78th Cong. 172 (1943) (testimony of former SEC Chairman Purcell) [hereinafter *Hearings on H.R. 1493*] (“[T]he rights that we are endeavoring to assure to the stockholders are those rights that he has traditionally had under State law, to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on.”). See also *Shareholder Proposals*, Exchange Act Release No. 56160, 2007 WL 2175940, at *3 (July 27, 2007) (“Thus, the federal proxy authority is not intended to supplant state law, but rather to reinforce state law rights with a sturdy federal disclosure and proxy solicitation regime.”); *Regulation of Communications Among Securityholders*, Exchange Act Release No. 30849, 1992 WL 151037, at *12 (June 23, 1992) (“While voting rights and the right to vote by proxy generally are determined by state law, federal regulation of the proxy solicitation process serves to make that right meaningful.”).

⁴ 17 C.F.R. § 240.14a-8 (2012).

⁵ See J. Robert Brown, Jr., *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATH. U. L. REV. 45, 48 (2007) (“Under state law, shareholders had the inherent right to make proposals or nominate directors from the floor of the meeting.”). Data on the number of proposals made at the meeting but not appearing in the proxy statement is apparently unavailable. *Amendments to Rules on Shareholder Proposals*, Exchange Act Release No. 40018, 1998 WL 254809, at *15 (May 21, 1998) (“We do not routinely record information on the number of ‘small businesses’ that receive non-rule 14a-8 proposals each year, since non-14a-8 proposals do not necessarily lead to a submission to the Commission.”).

management of discretionary authority to vote against any proposal that arises from the floor of the meeting and does not otherwise appear in a proxy statement.⁶ The transfer even applies where adequate notice of an impending proposal is provided and management has sufficient time and opportunity to obtain voting instructions from shareholders. Shareholders can only avoid the transfer of discretionary authority by circulating their own proxy statement or refusing to return the proxy card. Such a refusal forces the shareholder either to forego the right to vote or to attend the meeting and cast a ballot in person. Neither represents a satisfactory solution.

The policy reflected in Rule 14a-4 has been justified as beneficial to shareholders. The approach is convenient.⁷ The proxy process is rendered more efficiently.⁸ Imposing the restrictions avoids shareholder “confusion.”⁹ In fact, the discretionary authority provided under Rule 14a-4 is better understood as the byproduct of an uneven evolution in the development of the proxy rules. For much of the history of these provisions, shareholders were less organized and showed only modest interest in their impact on corporate governance. The rules, therefore, mostly reflected the interests of issuers. Rather than duplicating rights available at the meeting, they were used to restrict or reduce those rights.¹⁰

The approach to discretionary voting contained in Rule 14a-4 raises serious governance concerns. The system effectively forces shareholders to submit proposals under Rule 14a-8 for inclusion in the proxy statement. Only in these circumstances must management provide shareholders with the explicit right to vote for or against the matter and forgo the use of discretionary authority.¹¹ At the same time, however, reliance on Rule 14a-8 can have significant drawbacks. A

⁶ See *infra* Section III. The transfer must be disclosed.

⁷ See *infra* note 43.

⁸ See Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16356, 1979 WL 173198, at *4 (Nov. 21, 1979) (“It was further argued that the proposal would not only reduce the accuracy and efficiency of the tabulation process, but also would overly complicate the process of voting on a proxy card, thereby fostering shareholder disinterest and confusion.”).

⁹ See *infra* notes 45, 96.

¹⁰ See J. Robert Brown, Jr., *The Evolving Role of Rule 14a-8 in the Corporate Governance Process*, 93 DENV. L. REV. ONLINE 151, 152 (2016) [hereinafter Brown, *The Evolving Role of Rule 14a-8*] (with respect to Rule 14a-8, the Rule for the first five decades of existence “existed in an environment largely defined by issuer consternation and shareholder disinterest”).

¹¹ Even with matters specifically listed in the proxy card, management can exercise discretion over matters left blank. See *infra* Section III.A.

complicated provision often interpreted in an arbitrary fashion, shareholders must incur the expense of crafting a proposal that avoids application of the many substantive and procedural hurdles contained in the rule. In addition, they often must undertake the costs of defense when management seeks omission of the proposal from the proxy statement.¹²

More importantly, however, the rule is simply not available for some types of proposals. The Commission has categorically excluded entire topics from Rule 14a-8. Proposals are, for example, routinely excluded to the extent addressing the rotation, ratification or qualification of the outside auditor, despite the obvious importance of the topic to shareholders.¹³ A proposal in this area, therefore, can only be made through a separate proxy solicitation or from the floor of the meeting; reliance on Rule 14a-8 is entirely foreclosed. Yet when the proposal is made from the floor, management routinely obtains the discretionary voting authority to ensure defeat.¹⁴

This Article will trace the evolution of discretionary voting power under the proxy rules. The history is one of continuous expansion of the company's right to such authority. The Article will discuss the imperfect, indeed ineffective, mechanisms that can be used to prevent the transfer of discretionary voting authority from shareholders to management. Finally, the Article will examine possible changes in the regulatory regime that can address these concerns.

II. THE ANNUAL MEETING PROCESS

The requirements for shareholder meetings are governed by state law. For shareholders who cannot or will not physically attend the

¹² See *Shareholder Developments During the 2015 Proxy Season*, GIBSON DUNN (July 15, 2015), <http://www.gibsondunn.com/publications/Pages/Shareholder-Proposal-Developments-During-the-2015-Proxy-Season.aspx> (noting that issuers filed requests with the SEC to omit proposals with respect to 318 out of the 943 proposals submitted by shareholders).

¹³ See *infra* Section V.

¹⁴ See *State Street Corp.*, Proxy Solicitation Material (Schedule 14A), at 26 (March 2003), <https://www.sec.gov/Archives/edgar/data/93751/000009375103000018/proxy2003.htm> ("The Board of Directors does not know of any other matters that may be presented for action at the meeting, except that management has been informed that stockholders intend to submit a proposal to amend the By-Laws of the Corporation . . . If the proposal is properly brought before the meeting by the stockholders, the proxy holders intend to use their discretionary authority to vote against the proposal."). The proposal was made at the meeting and was defeated by a vote of 289,214,115 to 170 (with 1,231 shares abstaining or not voting). See *State Street Corp.*, Quarterly Report (Form 10-Q), at 34 (Mar. 31, 2003), <https://www.sec.gov/Archives/edgar/data/93751/000092701603002508/d10q.htm>.

meeting, voting takes place through the proxy process. For public companies, the proxy process is regulated by federal law and overseen by the SEC.¹⁵

A. State Law Requirements

Companies typically hold an annual meeting of shareholders at which directors are elected.¹⁶ Shareholders receive notice of the meeting and have the right to attend and vote their shares.¹⁷ For those present at the meeting, shares are typically voted by ballot.¹⁸ Shareholders may also designate a proxy or agent to attend the meeting and vote the shares in accordance with their instructions.¹⁹

Shareholders in attendance can nominate directors or make proposals from the floor of the meeting.²⁰ Described as a “default rule,”²¹ the right to present business at the meeting is a mix of common and statutory law.²² Shareholders do not, however, have an unlimited

¹⁵ See 17 C.F.R. §§ 240.14a-1 to 14b-2 (2012).

¹⁶ See *Hoschett v. TSI Int'l Software, Ltd.*, 683 A.2d 43, 44 (Del. Ch. 1996) (“The obligation to hold an annual meeting at which directors are to be elected, either for one year or for staggered terms, as the charter may provide, is one of the very few mandatory features of Delaware corporation law.”).

¹⁷ Fisch, *supra* note 1, at 1136 (“Presence at the annual meeting carries with it certain common-law rights, such as the right to nominate a candidate for the board of directors or to propose resolutions or transactions within the authority of the shareholders, such as a shareholder resolution or bylaw amendment.”).

¹⁸ See DEL. CODE ANN. tit. 8, § 211(e) (2009) (providing that all elections to the board shall be by ballot). See also DEL. CODE ANN. tit. 8, § 231(b) (2000) (requiring inspector of election to determine “the shares represented at a meeting and the validity of proxies and ballots” to “[c]ount all votes and ballots” and to “[c]ertify their determination of the number of shares represented at the meeting, and their count of all votes and ballots”). Proxy cards do not give to owners the same degree of choice. See *infra* note 168.

¹⁹ See MODEL BUS. CORP. ACT § 7.22(a) (2016) (allowing a shareholder to vote shares “in person or by proxy”).

²⁰ See Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1066 (1998) (“Under state law, labor and other shareholders can submit proposals for shareholder approval at the annual shareholders’ meeting, subject to compliance with any applicable bylaw provisions.”).

²¹ *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 954 A.2d 335, 344 (Del. Ch. 2008) (“CNET is correct that . . . if the Notice Bylaw is interpreted to apply only to 14a-8 proposals, then ‘any of CNET’s thousands of stockholders are free to raise for the first time and present any proposals they desire at the Annual Meeting.’ Although this may sound daunting, it is the default rule in Delaware.”), *aff’d*, 947 A.2d 1120 (Del. 2008).

²² George Ponds Kobler, *Shareholder Voting Over the Internet: A Proposal for Increasing Shareholder Participation in Corporate Governance*, 49 ALA. L. REV. 673, 675 (1998) (“State common law and statutory law gave shareholders the right to make proposals and vote at corporation meetings.”). Delaware provides that in addition to the election of

right to make proposals. Proposals can be ruled out of order to the extent they are inconsistent with the law or otherwise in violation of applicable bylaws and charter provisions.²³ The degree to which bylaws can impose limits on these common law rights by, for example, requiring a minimum share ownership threshold,²⁴ is unclear.²⁵

The most common restriction imposed by management on shareholder proposals concerns advance notice requirements.²⁶ Companies usually require that shareholders provide notice of any

directors “[a]ny other proper business may be transacted at the annual meeting.” See DEL. CODE ANN. tit. 8, § 211(e) (2009). Some types of proposals appear expressly authorized by statute. This includes, for example, the right of shareholders to propose bylaws. See DEL. CODE ANN. tit. 8, § 109(a) (2009) (“After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.”). See also *Hoschett v. TSI Int’l Software, Ltd.*, 683 A.2d 43, 45 (Del. Ch. 1996) (“[T]he purposes served by the annual meeting include affording to shareholders an opportunity to bring matters before the shareholder body, as provided by the corporations charter and bylaws, such as bylaw changes.”).

²³ Note, *Proxy Rule 14a-8: Omission of Shareholder Proposals*, 84 HARV. L. REV. 700, 702–03 (1971) (“Stockholders have no right, however, to obtain discussion or a vote on every proposal, since the chairman of the meeting may rule a proposal out of order if the proposal is not a proper subject for shareholder action under state law or the charter or by-laws of the company.”).

²⁴ Ashford Hospitality Prime, Inc., Proxy Solicitation Material (Schedule 14A), at 45 (May 12, 2015), <https://www.sec.gov/Archives/edgar/data/1574085/000104746915003607/a2224229zdef14a.htm> (seeking shareholder approval of bylaw that would limit nominees and proposals to shareholders “of record” that owned at least 1 percent of the shares continuously for at least one year). The proposal, however, was not approved by shareholders. See Ashford Hospitality Prime, Inc., Current Report (Form 8-K) (May 18, 2015), <https://www.sec.gov/Archives/edgar/data/1574085/000157408515000037/ahp2015annualshareholdervo.htm> (For: 3,420,750; Against: 15,309,178; Abstain: 15,499; Broker non-votes: 1,992,587). A majority of shareholders also voted against the proposal at Ashford Hospitality Trust. See Ashford Hospitality Trust, Current Report (Form 8-K) (May 12, 2015), <https://www.sec.gov/Archives/edgar/data/1232582/000123258215000079/ah2015annualshareholdervo.htm>.

²⁵ Some have argued that they have the right to impose limits on these types of rights. See Susan W. Liebler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425, 463 (1984) (“A bylaw provision requiring minimum share ownership in order to bring matters before the shareholders meeting of a for-profit corporation would appear even more likely to withstand judicial scrutiny. If the bylaws of such a corporation required five percent share ownership in order to bring a matter before the meeting, a proposal from a shareholder holding fewer shares would be an improper matter for shareholder action under state law.”).

²⁶ See *CNET Networks, Inc.*, 954 A.2d at 344 (“An advance notice bylaw is one that requires stockholders wishing to make nominations or proposals at a corporation’s annual meeting to give notice of their intention in advance of so doing.”).

impending proposal several months before the meeting.²⁷ A shareholder who fails to provide the requisite advance notice may be barred from making the proposal.²⁸

B. Shareholder Proposals and the Proxy Rules

Public companies are subject to the federal proxy rules.²⁹ Rule 14a-8 permits shareholders to include in the company's proxy statement a properly submitted proposal. Management, in turn, must provide shareholders with the right to vote for or against the matter.³⁰ Those submitting a proposal are required to attend the meeting and "present" the matter from the floor.³¹

At one time, the requirements of Rule 14a-8 largely coexisted with those set out under state law. The initial version of the rule allowed for the submission of a proposal by any shareholder, without reference to a minimum ownership threshold or holding period.³² Proposals were to be included so long as they constituted a proper subject for shareholders,³³ a standard that turned on state law.³⁴

The overlap, however, did not last. With the adoption of the first significant set of amendments to the rule in 1948,³⁵ the Commission

²⁷ See *Harbinger Capital Partners Fund I, Ltd. v. Nw. Corp.*, No. 1937-N, 2006 WL 572823, at *1 (Del. Ch. Feb. 23, 2006) (bylaw requiring shareholder "to identify its slate of proposed board candidates three months in advance of the meeting").

²⁸ In the absence of these types of provisions, any of a company's "thousands of stockholders are free to raise for the first time and present any proposals they desire at the Annual Meeting." *CNET Networks, Inc.*, 954 A.2d at 344.

²⁹ See Securities Exchange Act of 1934, ch. 404, § 14(a), 48 Stat. 895 (codified as amended at 15 U.S.C. § 78n (2012)) (proxy rules apply to companies registered under Section 12 of the Exchange Act).

³⁰ 17 C.F.R. § 240.14a-8(a) (2012). The impetus for the rule, however, did not arise from the desire to enhance the right of shareholders. Instead, the provision was primarily designed to alleviate management's obligation to disclose an impending shareholder proposal in the proxy statement. See Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 153. By allowing shareholders to submit the proposal for inclusion in the proxy statement, the Rule effectively shifted the disclosure obligations to the proponent.

³¹ See Rule 14a-8(h), 17 C.F.R. § 240.14a-8(h) (2012).

³² See Exchange Act Release No. 3347, 1942 WL 34864 (Dec. 18, 1942).

³³ *Id.*

³⁴ Opinion of Baldwin B. Bane, Exchange Act Release No. 3638, 1945 WL 27415, at *2 (Jan. 3, 1945) ("Speaking generally, it is the purpose of Rule X-14A-7 to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized.").

³⁵ Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4185, 1948 WL 28695 (Nov. 5, 1948). For a discussion of the 1948 amendments, see Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 154.

began to impose conditions that deviated significantly from the requirements of state law.³⁶ The number of exclusions grew from one to thirteen; eligibility was made contingent upon stock holdings and tenure.³⁷ Moreover, while the changes had a variety of explanation, at least some were apparently designed to reduce shareholder access to Rule 14a-8.³⁸ As a result, increasingly broad categories of proposals were eligible for omission from the proxy statement but were permissible under state law and could be raised from the floor of the meeting.

III. SHAREHOLDER VOTING RIGHTS AND THE PROXY CARD

For shareholders of public companies unable or unwilling to attend the meeting,³⁹ voting typically occurs through the execution of a proxy card.⁴⁰ The card designates a third party to attend the meeting and vote the shares as instructed. Because the card usually comes from management, the third party is invariably appointed by the company and is often an officer.⁴¹

³⁶ The evolution of these changes is discussed in Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10.

³⁷ See Rule 14a-8(b), 17 C.F.R. § 240.14a-8(b) (2012) (requiring shareholder to “have continuously held at least \$2,000 in market value, or 1%, of the company’s securities entitled to be voted on the proposal at the meeting for at least one year”); *id.* § 240.14a-8(h)(1)–(13) (listing thirteen exclusions). These requirements and restrictions were generally required under state law. See Fisch, *supra* note 1, at 1149 (“No uniform state or common law principle requires that a shareholder hold one percent or one thousand dollars’ worth of a corporation’s stock for a minimum of one year before making a motion at a shareholders’ meeting. No state law bars a shareholder from making the same motion or proposal in successive years, yet Rule 14a-8(c)(12) limits a shareholder’s ability to do so. Additionally, state law does not restrict shareholders to dealing with issues concerning more than five percent of the corporation’s total assets or extraordinary business matters. The SEC, however, has imposed these limits on shareholder democracy.”).

³⁸ Fisch, *supra* note 1, at 1149 (“Many of the restrictions imposed by the proxy rules can be attributed to a pragmatic effort by the SEC to limit the number of shareholder proposals and to restrict use of the proxy statement to issues of general importance to shareholders.”).

³⁹ In addition to the costs of attending, institutional investors holding shares in a large number of issuers would need to physically attend a large number of meetings in a short period of time. See *infra* note 118.

⁴⁰ Listed companies are required to solicit proxies. See NYSE Rule 402.04(A), http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_5/chp_1_5_2/default.asp (“Actively operating companies are required to solicit proxies for all meetings of shareholders.”). Of course, most owners today hold shares in street name accounts and execute voting instructions. These documents are not proxies but are sent to brokers (or their agents) and eventually transferred to a proxy card. See discussion at *infra* Part IV.D.

⁴¹ See Whole Foods Mkt., Inc., Proxy Statement (July 30, 2015), at 3, <http://www.sec.gov/Archives/edgar/data/865436/000120677415002458/wholefood>

Under Rule 14a-4,⁴² the proxy card must “identify clearly and impartially each separate matter intended to be acted upon, whether or not related to or conditioned on the approval of other matters, and whether proposed” by the company or shareholders.⁴³ Shareholders are to be “afforded an opportunity to specify by boxes” the choice of approval, disapproval, or abstention from “each separate matter. . . .”⁴⁴ Shares reflected in the proxy card are voted at the meeting “by means of a ballot.”⁴⁵ The proxy can only be used for a single meeting and any adjournment.⁴⁶

s_def14a.htm (“If you grant a proxy, the persons named as proxy holders, John Mackey and Walter Robb, will have the discretion to vote your shares on any additional matters properly presented for a vote at the meeting in accordance with Texas law and our Bylaws.”). Both were officers of the company. *Id.* (“John Mackey and Walter Robb are officers of the Company and were named by our Board of Directors as proxy holders. They will vote all proxies, or record an abstention or withholding, in accordance with the directions on the proxy. If no contrary direction is given, the shares will be voted as recommended by the Board of Directors.”).

⁴² The early rules indicated that companies soliciting proxies had to provide shareholders with a “definite means” to vote. *See* Exchange Act Release No. 1823, 1938 WL 33169, at *1 (Aug. 11, 1938) (“In other words, the proxy must provide some definite means whereby the security holder may indicate how he desires his vote to be cast on a given proposition and whereby the authority of the holders of the proxy will be limited accordingly.”). The need for a “definite means” of voting in the “form of proxy or otherwise” proved to be subject to abuse. *See* Exchange Act Release No. 2771, 1941 WL 36908, at *1 (Feb. 8, 1941) (“Some corporations have followed the practice of enclosing with the proxy a separate slip of paper on which security holders may indicate their vote. The Commission has been informed that this practice has led to confusion in the minds of security holders, in that many did not understand that it was necessary to return two separate instruments to the corporation in order to specify their vote.”). The Commission, therefore, mandated that voting take place on the proxy card. *Id.* (“The proxy form itself is the generally accepted instrument through which a stockholder gives authority to persons to represent him at the meeting. The Commission knows of no valid practical reason for separating the vote from the proxy itself. It is of the opinion that the separate slip has been used in order to discourage security holders from exercising their voting privileges. The Commission has therefore decided to amend its rules to require that the space to specify the action desired shall be included in the form of proxy itself.”).

⁴³ 17 C.F.R. § 240.14a-4(a)(3) (2012). *See also* Exchange Act Release No. 1823, 1938 WL 33169, at *1 (Aug. 11, 1938) (companies must provide a mechanism for shareholders to “indicate how he desires his vote to be cast on a given proposition and whereby the authority of the holders of the proxy will be limited accordingly”).

⁴⁴ The requirements with respect to the election of directors are somewhat different. For example, shareholders do not have the right to vote against but may “withhold authority” for each nominee. *See* 17 C.F.R. § 240.14a-4(b) (2012). *But see* 17 C.F.R. § 240.14a-4(b) (“If applicable state law gives legal effect to votes cast against a nominee, then in lieu of, or in addition to, providing a means for security holders to withhold authority to vote, the registrant should provide a similar means for security holders to vote against each nominee.”).

⁴⁵ 17 C.F.R. § 240.14a-4(e) (2012).

⁴⁶ *Id.* § 240.14a-4(d).

The rule, therefore, presupposes that shareholders will be given a choice on all matters to be voted upon at the meeting and that their shares will only be voted in accordance with the choices made on the proxy card. In fact, however, the rule does not operate in such a fashion. In at least two instances, a company may vote an owner's shares without instruction.

First, a proxy may provide management with the authority to vote the portions of the card deliberately left blank by the shareholder.⁴⁷ Second, companies can use the card to obtain discretionary authority to vote on matters not listed on the proxy card. This includes proposals that management knows will be made from the floor well in advance of the meeting.

A. *Partially Completed Proxy Cards*

Rule 14a-4 provides management with the authority to vote any portion of the proxy card left blank by the shareholder. First authorized in 1938,⁴⁸ management gained the right to vote for matters "not specified" by the shareholder "provided that the form of proxy states in bold-face type how it is intended to vote the shares represented by the proxy in each such case."⁴⁹ Management only had to disclose a "bona fide intention" with respect to the unmarked portions of the proxy card, something that could presumably be changed "[i]f later events" made it "unwise to vote in the manner stated. . . ."⁵⁰ The Commission justified the approach as a "convenience" for shareholders.⁵¹ Aware that the company would vote the shares in favor of management, shareholders benefited by avoiding the need to execute the entire card.⁵² Almost from the beginning,

⁴⁷ See *infra* notes 48–59.

⁴⁸ Exchange Act Release No. 1823, 1938 WL 33169, at *3 (Aug. 11, 1938) ("Nothing in Regulation X-14 shall prevent the solicitation of a proxy conferring discretionary authority with respect to matters . . . not known or determined at the time of the solicitation, or with respect to elections of directors or other officials.").

⁴⁹ 17 C.F.R. § 240.14a-4(b)(1) (2012).

⁵⁰ Notice of Proposal to Revise Proxy Rules, Exchange Act Release No. 3998, 1947 WL 25504, at *1 (Oct. 10, 1947) ("The requirements as to the form of proxy have been amended to provide that where a security holder does not mark the ballot, the proxy holder is required to state only his bona fide intention as to the way in which the shares represented by the proxy will be voted. If later events make it unwise to vote in the manner stated, the proxy holder may then vote the shares in his discretion.").

⁵¹ Christie Nicks, Note, *Voting Partially Instructed Shares by Brokers*, 91 DENV. L. REV. ONLINE 155, 161 (2014) ("The authority apparently arose from the belief that a blank item on the proxy was deliberate and reflected an intention by shareholders to support management."), <http://www.denverlawreview.org/dlr-onlinearticle/2014/4/19/voting-of-partially-instructed-shares-by-brokers.html>.

⁵² Shareholder Communications, Shareholder Participation in the Corporate

however, shareholders objected to the “convenience” as inconsistent with their actual intent.⁵³ Eventually, the Commission proposed to do away with the authority.⁵⁴ Issuers, however, objected, asserting that shareholders benefited from the status quo,⁵⁵ would be harmed by the change⁵⁶ and, in any event, would require “extensive reeducation” to adjust to any amendments.⁵⁷ The Commission left the authority in

Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16104, 1979 WL 170069, at *5 (Aug. 13, 1979) (proposing release) (“Certain commentators, noting that shareholders are advised how unmarked proxies will be voted, concluded that the affirmative acts of signing the proxy card and returning it to the issuer were substantial evidence of a shareholder’s intention to grant the issuer authority to vote his shares.”).

⁵³ U.S. Secs. & Exch. Comm’n, Summary of Proposed Revision of Proxy Rules (Aug. 15, 1942), http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1940/1942_0819_SECProxyT.pdf (“Under the present rules, a number of managements have drafted proxies so that the failure of a security holder to indicate how he desired his vote cast on a particular proposal vested authority in the management to vote the proxy in support of its position on the proposal. Many investors have commented that management should be permitted to vote only those proxies specifically marked. It is proposed that this suggestion be adopted as part of the amended rules.”). *See also* Exchange Act Release No. 16104, 1979 WL 170069, at *5 (Aug. 13, 1979) (“[S]everal other commentators objected to permitting issuers to vote unmarked proxies. . . . Such a result may not be consistent with the intent of shareholders and could dilute the meaning of the vote conveyed to the issuer’s board of directors.”).

⁵⁴ *See* Exchange Act Release No. 16104, 1979 WL 170069 (Aug. 13, 1979) (proposing release). *See also* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16356, 1979 WL 173198, at *8 (Nov. 21, 1979) (adopting release) (“Rule 14a-4(b)(3), as proposed, would have prohibited a form of proxy from conferring discretionary authority to vote with respect to any matter as to which the security holder is afforded an opportunity to specify a choice and no specification has been made.”).

⁵⁵ Exchange Act Release No. 16356, 1979 WL 173198, at *8 (Nov. 21, 1979) (adopting release) (“A few corporations also were concerned that disregarding unmarked proxies would tend to increase artificially the percentage of votes cast in favor of shareholder proposals, which might result in adoption of special interest proposals not supported by security holders on the whole.”).

⁵⁶ *Id.* (“Most commentators who opposed the proposed rule asserted that a significant number of proxies are returned each year signed but unmarked and believed that there is little reason to doubt that shareholders intend an unmarked proxy to be voted for management’s positions.”). Unsurprisingly, shareholders had a different perspective. *Id.* (“One shareholder contended that an unmarked proxy evidenced a desire to have the security holder’s vote counted only for purposes of achieving a quorum at the meeting of security holders. Shareholder intentions are unclear, according to another commentator, because some companies ‘attempt to make return of a signed and dated proxy card as automatic and unthinking a process as possible.’”).

⁵⁷ *Id.* (“Commentators foresaw numerous problems if the rule were adopted as proposed. Chief among their concerns was the fear that shareholders would continue to return unmarked proxies intending to grant voting authority to the proxy. In the opinion of many commentators, extensive re-education efforts would be needed to

place⁵⁸ and merely admonished companies to “make greater efforts to encourage securities holders to vote on the matters to be considered at the meeting.”⁵⁹

B. Discretionary Authority

Perhaps the most significant diminution of shareholder voting rights, however, arose from the involuntary transfer of discretionary authority from shareholders to management. For matters not set out in the proxy card, companies could obtain the right, with proper disclosure, to vote the shares at their discretion. The card itself presented no opportunity to block the transfer. Shareholders could only do so by failing to return the proxy to the company or engaging in a counter solicitation.

1. Rule 14a-4(c)(1): “Unexpected” Matters

The earliest version of the proxy rules allowed management to obtain discretionary authority for matters not known at the time of the distribution of the proxy materials.⁶⁰ As one commentator described, the provision “provide[d] companies and other soliciting persons some flexibility to cope with the emergence of unanticipated matters that arise shortly before or during the meeting.”⁶¹ The authority was not, however, automatic.⁶² Shareholders had to be informed in “bold-

alter this traditional mode of shareholder response.”).

⁵⁸ The release acknowledged the benefits accorded management. *See id.* at *9 (“The Commission is sensitive to the possibility that adoption of the rule, as proposed, could impede attainment of a specified percentage of votes needed to adopt measures important to issuers’ operations.”).

⁵⁹ *Id.* (“The help minimize[s] the number of abstentions when significant proposals recommended by the board of directors are voted upon and to clarify the meaning of signed but unmarked proxies, the Commission requests issuers to make greater efforts to encourage security holders to vote on the matters to be considered at the meeting.”). For a discussion of the voting of partially executed voting instruction forms, see Christie Nicks, Note, *Voting Partially Instructed Shares by Brokers*, 91 DENV. L. REV. ONLINE 155 (2014), <http://www.denverlawreview.org/dlr-onlinearticle/2014/4/19/voting-of-partially-instructed-shares-by-brokers.html>.

⁶⁰ *See* Exchange Act Release No. 1823, 1938 WL 33169 (Aug. 11, 1938). The authority was not intended to apply to a proposal made by the solicitor of the proxy. *See Aegis Corp. v. Goldman*, 523 F. Supp. 1273, 1279 n.3 (S.D.N.Y. 1981) (“The general counsel of the S.E.C. has submitted a letter in support of plaintiff’s application. Letter from Ralph E. Ferrara, Office of the General Counsel, to Judge Vincent L. Broderick (July 21, 1981). . . . He urges that Rule 14a-4(c) (1) should be so interpreted that it does not authorize the invocation of discretionary authority to vote for proposals made by the proxy solicitor or proxy holder himself.”).

⁶¹ Schwab & Thomas, *supra* note 20, at 1066–67.

⁶² *Aegis*, 523 F. Supp. at 1278 (“Thus a proxy confers specific authority to vote with respect to the matters specifically designated therein, and it may (but need not) confer

faced type” on the surface of the proxy card.⁶³ Nonetheless, companies routinely obtained the authority.⁶⁴

The use of discretionary authority allowed management, not shareholders, to determine the outcome of motions to adjourn and other unexpected items that could arise at the meeting. Particularly with respect to procedural matters, the transfer of authority had a certain logic. Rather than leave decisions to the random owners who happened to be at the meeting, the power resided in managers who also had a legal obligation to act in the best interests of shareholders.⁶⁵ Companies eventually obtained the explicit authority to vote on a variety of non-substantive matters, including approval of the minutes⁶⁶ and anything “incident to the conduct of the meeting.”⁶⁷

discretionary authority to vote with respect to various specified other matters.”).

⁶³ Exchange Act Release No. 3347, 1942 WL 34864, at *8 (Dec. 18, 1942) (“Nothing in Regulation X-14 shall prevent the solicitation of a proxy conferring discretionary authority with respect to matters as to which the person solicited does not make the specification provided for above if the ballot is clearly set forth in the form of proxy and the form of proxy contains a statement in bold-face type indicating that if the ballot is not marked the shares represented by the proxy will nevertheless be voted in a specified manner.”). *See also* Frank D. Emerson & Franklin C. Latham, *SEC Proxy Regulation: Steps Toward More Effective Stockholder Participation*, 59 YALE L.J. 635, 663 (1950) (“But it did amend the X-14A-4(c) requirements with respect to matters which the solicitor is not aware at the time of the solicitation are to be presented, provided that a specific statement is made to that effect in the proxy form or statement.”).

⁶⁴ *See* Comm. for New Mgmt. of Guar. Bancshares Corp. v. Dimeling, 772 F. Supp. 230, 238 (E.D. Pa. 1991) (“The Committee proxy card contained the following line: ‘In their discretion, the proxyholders are authorized to vote upon such other business as may properly come before the meeting.’ The vesting of discretionary authority in proxyholders is standard. Indeed, it is advisable since any shareholder may introduce a question to be voted upon at a shareholder’s meeting.”).

⁶⁵ *See* J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 318 (2004) (delineating fiduciary obligations of the board of directors). The Commission also took steps to prevent the authority from being manipulated. The party soliciting proxies could not use the discretionary authority to support their own initiatives. Proxy Rules – Comprehensive Review, Exchange Act Release No. 23789, 1986 WL 722059, at *4 (Nov. 10, 1986) (noting that the purpose of the discretionary authority provision was “only to allow the party filing the proxy statement to respond to proposals initiated by others”). *See also* Marshall & Ilsley Corp., SEC No-Action Letter, 1984 WL 45426 (July 12, 1984) (declining to issue no action relief with respect to a shareholder resolution and that “[i]n reaching this conclusion, we have especially noted that this matter as to which discretionary authority was exercised in the voting of proxies solicited by the Company’s Board was a matter proposed by the Board itself”).

⁶⁶ 17 C.F.R. § 240.14a-4(c)(4) (2012).

⁶⁷ *Id.* § 240.14a-4(c)(7). The rules also permitted the exercise of discretionary authority when bona fide replacement candidates were nominated to replace those disclosed in the proxy materials. *See id.* § 240.14a-4(c)(5). These additions to the rule reflected administrative practice. *See* Adoption of Amendments to Proxy Rules and Information Rules, Exchange Act Release No. 8206, 1967 WL 88215, at *1 (Dec. 14,

The right to vote on a discretionary basis with respect to other types of “unexpected” matters, however, remained. Moreover, companies were allowed to treat as “unknown” matters actually known to management long before the meeting date. Initially, discretionary authority could only be obtained for matters unknown “at the time the solicitation [was] made. . . .”⁶⁸ The language eventually changed to proposals unknown a “reasonable time” before the solicitation.⁶⁹ The staff narrowly interpreted the requirement and declined to allow the use of discretionary authority where management learned of a proposal twelve days before the meeting.⁷⁰

Eventually, however, “reasonable time” transformed into forty-five days before the distribution of proxy materials from the prior year or the date specified in an advance notice bylaw.⁷¹ Although described as a “benefit” to shareholders,⁷² the change effectively meant that

1967) (“Administrative practice of the Commission has heretofore permitted a proxy to confer discretionary authority with respect to the approval of the minutes of a prior meeting where such approval does not amount to ratification of action taken at such meeting, with respect to matters incident to the conduct of the meeting, and with respect to the election of any person to any office for which a bona fide nominee is named in the proxy statement and such nominee is unable to serve or for good cause will not serve.”).

⁶⁸ Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4185, 1948 WL 28695 (Nov. 5, 1948).

⁶⁹ Amendment of Proxy Rules, Exchange Act Release No. 4775, 1952 WL 5254, at *4 (Dec. 11, 1952) (“A proxy may confer discretionary authority with respect to other matters which may come before the meeting, provided the persons on whose behalf the solicitation is made are not aware a reasonable time prior to the time the solicitation is made that any such other matters are to be presented for action at the meeting and provided further that a specific statement to that effect is made in the proxy statement or in the form of proxy.”).

⁷⁰ *Larkin v. Baltimore Bancorp*, 769 F. Supp. 919, 925 (D. Md. 1991) (quoting statement from Gregg W. Corso, Special Counsel, Office of Tender Offers, SEC, May 14, 1991) (internal quotations omitted) (“Consistent with Rule 14a-4, a solicitor may not exercise discretionary authority granted by a proxy with respect to matters known a reasonable time prior to the meeting. Exercising discretionary authority with respect to matters known twelve days prior to the meeting does not appear consistent with the requirements of the rule. . . .”). Management could rely on discretionary authority if providing shareholders who had already returned a proxy card with an opportunity to revoke the authority. See *United Mine Workers of Am. v. Pittson Co.*, No. 89-0962, 1989 WL 201060, at *3 (D.D.C. Nov. 24, 1989) (Letter from William E. Morley, Chief Counsel, Division of Corporation Finance, to John E. Young (June 7, 1989)) (“It is the staff’s view, however, that where the management is made aware of the matter in sufficient time before the meeting, there are two options available: either the new matter is reflected on a new proxy card and the security holders thus are given the opportunity to revoke previously given discretionary authority as to the matter or it is not added and the discretionary authority does not apply to the matter.”).

⁷¹ See 17 C.F.R. § 240.14a-8(c)(1) (2012).

⁷² Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39093, 1997 WL 578696, at *21 (Sept. 18, 1997) (asserting that the adoption of a 45-

proposals submitted well before the meeting⁷³ could be treated as “unknown” for purposes of the exercise of discretionary authority.⁷⁴

2. Rule 14a-4(c) (6): Proposals “Omitted” under Rule 14a-8

In addition to “unknown” matters, companies were allowed to use discretionary authority to vote against proposals that were in fact entirely known. Rule 14a-8 required shareholders in most cases to submit proposals to management 120 days prior to the date the proxy materials were distributed the previous year.⁷⁵ As a result, management became aware of a proposal well before the annual meeting.

Even when timely, however, not all of these proposals ended up in the proxy statement. In some cases, the Commission issued a no-

day time period would “not only provide clearer guidelines for shareholders and companies, but also benefit investors by helping to ensure that companies are notified of proposals sufficiently in advance of the annual meeting to provide shareholders a meaningful opportunity to review related disclosures in the proxy statement”).

⁷³ See *Harbinger Capital Partners Fund I, Ltd. v. Nw. Corp.*, No. 1937-N, 2006 WL 572823 (Del. Ch. Feb. 23, 2006).

⁷⁴ The release included one example. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40018, 1998 WL 254809, at *6 (May 21, 1998) (“As an example, assume a company mailed this year’s proxy materials on March 31, 1998 for an annual meeting on May 1, 1998. Next year, the company also schedules an early May annual meeting. The notice date established by new rule 14a-4(c) (1) for non-14a-8 proposals is forty-five calendar days before March 31, or February 14. Thus February 14, 1999 would represent the notice date for the purposes of amended rule 14a-4(c) (1) unless a different date is established by an overriding advance notice provision in the company’s charter or bylaws.”).

⁷⁵ See Rule 14a-8(e), 17 C.F.R. § 240.14a-8(e) (2012). The period has been steadily lengthened over the years. See Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20091, 1983 WL 33272, at *4 (Aug. 16, 1983) (extending the deadline for submitting proposals from 90 days to 120 in order to “to give issuers and the Commission’s staff adequate time to process proposals”); Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 19771, 1976 WL 160347, at *4 (Nov. 22, 1976) (extending the deadline for submitting proposals from 70 to 90 days and noting that the Commission “believes that the inconvenience will be minimal and is outweighed by the fact that the new timeliness deadlines will provide an additional 20 days for proponents to explore all possible alternatives in connection with a management’s intention to omit their proposals”); Title 17—Commodity and Securities Exchanges, Chapter II—Securities and Exchange Commission, Exchange Act Release No. 9784, 1972 WL 125400, at *2 (Sept. 22, 1972) (extending the deadline for submitting proposals from 60 to 70 days, a change described as “technical in nature”); Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979, 1954 WL 5772, at *1 (Jan. 6, 1954) (increasing the period from 30 to 60 days “so as to give more time for the consideration of security holder proposals”). For most annual meetings, proposals must be submitted no earlier than 120 days from the date of distribution of the proxy materials during the prior year. 17 C.F.R. § 240.14a-8(e) (2) (2012). Where the company did not hold an annual meeting or has changed the meeting date by more than 30 days, “the deadline is a reasonable time before the company begins to print and send its proxy materials.” *Id.*

action letter authorizing omission.⁷⁶ In other instances, shareholders withdrew the proposal voluntarily. Omission or withdrawal under Rule 14a-8 did not preclude a shareholder from raising the same issue from the floor of the meeting.⁷⁷ As a result, companies confronted the risk that a proposal not included in the proxy statement would nonetheless be considered by shareholders at the upcoming meeting.

An early version of Rule 14a-4⁷⁸ allowed management to obtain discretionary authority to vote against proposals omitted under Rule 14a-8.⁷⁹ To do so, the company only had to disclose the intended use of the authority,⁸⁰ although additional information was required where

⁷⁶ For a description of the no action letter process, see Courtney E. Bartkus, Note, *Appealing No-Action Responses under Rule 14a-8: Informal Procedures of the SEC and the Availability of Meaningful Review*, 93 DENV. L. REV. ONLINE 199 (2016), <http://www.denverlawreview.org/dlr-onlinearticle/2016/5/6/appealing-no-action-responses-under-rule-14a-8-informal-proc.html>.

⁷⁷ See *supra* note 1. See also Exchange Act Release No. 39093, 1997 WL 578696, at *20 (Sept. 18, 1997) (“If a shareholder submits a proposal under rule 14a-8 to be included in the company’s proxy materials, but the company properly excludes the proposal, rule 14a-4(c)(4) permits the company to exercise discretionary voting authority to vote uninstructed proxies against that proposal if the shareholder chooses an alternative route for its presentation to a vote. The proponent may, for instance, intend to present the proposal from the floor of the company’s annual meeting, or solicit proxy votes independently by distributing its own proxy statement and form of proxy.”).

⁷⁸ Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4185, 1948 WL 28695, at *1 (Nov. 5, 1948) (“Rule X-14A-4 is amended to provide that proposals so omitted need not be referred to in the form of proxy and that the proxy may confer discretionary authority with respect to such proposals.”).

⁷⁹ The amendments were likely motivated by the simultaneous decision to expand the number of substantive grounds for excluding a proposal. As originally drafted, Rule 14a-8 (then X-14a-7) only allowed for the exclusion of proposals that were not proper subjects for shareholder action. To the extent excluded on this basis, shareholders presumably lacked the authority to make the same proposal at the annual meeting. See, e.g., The Wash. Post Co., SEC No-Action Letter, 1973 SEC No-Act. LEXIS 1447, at *3 (Feb. 22, 1973) (proposal excluded because proposing shareholders lacked the authority to vote on the matter; if proposal made at meeting, shareholder would be “ruled out of order”). In 1948, however, the Commission added grounds for exclusion that went beyond the boundaries of state law. The amendments, therefore, raised the possibility that a proposal omitted under Rule 14a-8 could still be made from the floor of the meeting. The amendments to Rule 14a-4 made certain that management would have sufficient votes to ensure defeat of the proposal to the extent that occurred.

⁸⁰ Pacific Enters, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 447, at *2 (Mar. 9, 1990) (“When a shareholder proposal has been excluded pursuant to the provisions of rule 14a-8, the proposal may still be presented at the meeting. Thus, issuers’ proxy statements should disclose the possibility that proposals omitted pursuant to rule 14a-8 may be raised at the meeting and the proxies will be voted in the discretion of the proxy holders.”). See also Schwab & Thomas, *supra* note 20, at 1071 (“If the company intends to exercise discretionary authority to vote on the excluded proposal if it is subsequently presented by the union on the floor at the meeting, however, then the

management actually knew that a proposal would be made at the meeting.⁸¹ The proxy card did not have to include any mechanism to allow shareholders to withhold the transfer of discretionary authority with respect to the omitted proposal.

Initially, discretionary authority could only be used to vote against proposals omitted for substantive reasons.⁸² Amendments adopted in 1967, however, expanded the use of discretionary voting to proposals omitted for any reason, including the failure to observe procedural formalities.⁸³ Management could, therefore, use the authority to vote

SEC has taken the position that the company must have disclosed fully in its proxy statement the possibility that the excluded shareholder proposal might be raised at the meeting and that, in such event, the proxy will be voted in the discretion of the holder in order to exercise discretionary authority under this rule.”).

⁸¹ The staff sometimes comments on the level of disclosure associated with discretionary authority. One example involved a back and forth between the Office of Mergers & Acquisitions at the SEC and counsel for Hospitality Properties Trust. See Letter from David L. Orlic, Special Counsel, Office of Mergers & Acquisitions, SEC, to Mark L. Kleifges, Chief Fin. Officer, Hospitality Properties Trust (Mar. 11, 2015), <https://www.sec.gov/Archives/edgar/data/945394/00000000015014590/filename1.pdf>; see also Letter from Margaret R. Cohen, Skadden, Arps, to David L. Orlic, Special Counsel, Office of Mergers & Acquisitions, SEC (Mar. 16, 2015), <https://www.sec.gov/Archives/edgar/data/945394/000110465915019762/filename1.htm>. After another letter from the staff (see Letter from David L. Orlic, Special Counsel, Office of Mergers & Acquisitions, SEC, to Mark L. Kleifges, Chief Fin. Officer, Hospitality Properties Trust (Mar. 18, 2015), <https://www.sec.gov/Archives/edgar/data/945394/00000000015016176/filename1.pdf>), the company agreed to increase the level of disclosure. See Letter from Thomas W. Greenberg, Skadden, Arps, to Office of Mergers & Acquisitions, SEC (Mar. 19, 2015), <https://www.sec.gov/divisions/corpfin/cf-noaction/2015/danaher-corporation-051315-13e4-incoming.pdf>. For the disclosure on the matter included in the proxy statement, see Hospitality Properties Trust (Schedule 14A) (Mar. 19, 2015), <https://www.sec.gov/Archives/edgar/data/945394/000104746915002486/a2223826zprer14a.htm>.

⁸² A proxy card could provide discretionary authority for any proposal “omitted from the proxy statement and form of proxy pursuant to paragraph (c) of Rule X-14A-8.” Rule X-14A-4(c), *reprinted in* Amendment of Proxy Rules, Exchange Act Release No. 4775, 1952 WL 5254, at *2–19 (Dec. 11, 1952). Subsection (c) of Rule X-14A-8 permitted the exclusion of proposals to the extent involving a “personal claim or redressing a personal grievance,” to the extent the shareholder failed to present the proposal at two consecutive meetings, and upon resubmission of substantially the same proposal without having obtained at least three percent of the votes cast. *Id.*

⁸³ The changes were not in the proposing release. See Notice of Proposed Amendments to Proxy Rules and Information Rules, Exchange Act Release No. 8000, 1966 WL 85608 (Dec. 5, 1966). See also Adoption of Amendments to Proxy Rules and Information Rules, Exchange Act Release No. 8206, 1967 WL 88215, at *2 (Dec. 14, 1967) (“Heretofore, discretionary authority was permitted by this provision only with respect to proposals omitted pursuant to paragraph (c) of Rule 14a-8. The amendment will thus permit discretionary authority to vote with respect to proposals which are not submitted within the period of time specified in the rule, as well as those which may be omitted pursuant to paragraph (c), and with respect to proposals which

against proposals excluded because the shareholders missed a deadline or failed to provide adequate evidence of stock ownership.⁸⁴ In addition, administrative interpretations broadened application of the authority to proposals that did not explicitly invoke Rule 14a-8⁸⁵ or were withdrawn before the staff ruled on the no action request.⁸⁶

3. Rule 14a-4(c)(2): “Non-Rule 14a-8 Proposals”

Discretionary authority applied to matters “unknown” before the meeting. The authority also applied to proposals “omitted” under Rule 14a-8.⁸⁷ For most of the existence of Rule 14a-4, however, timely

are false or misleading.”).

⁸⁴ In addition to proposals omitted under Rule 14a-8, discretionary authority can be used to vote against a proposal omitted under the antifraud provision contained in Rule 14a-9. Rule 14a-4(c)(6), 17 C.F.R. § 240.14a-4(c)(6) (2012). *See* Exchange Act Release No. 8206, 1967 WL 88215 (Dec. 14, 1967). Added in 1967, the provision appears redundant. The right to exclude proposals for violations of Rule 14a-9 was only added in 1976. *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12999, 1976 WL 160347, at *9 (Nov. 22, 1976) (noting that the provision “formalize[d] a ground for omission that the Commission believes has been inherent in the proxy rules”). The change made the need for a reference to Rule 14a-9 redundant. Nonetheless, retention of the language suggests that a company can omit a proposal as misleading without relying on Rule 14a-8 and use discretionary authority to vote against the matter if it is subsequently raised at the meeting.

⁸⁵ *See* Texaco, Inc., SEC No-Action Letter, 1997 WL 64007, at *5 (Feb. 14, 1997) (“Although the Proponent makes no reference to Rule 14a-8 in his letter (and does not indicate a desire to have his two proposals included in the Company’s proxy statement), Rule 14a-8 itself would require Texaco to include the proposals in its proxy materials, unless the requirements in subparagraph (a) of Rule 14a-8 are not met or one or more of the exceptions set forth in subparagraph (c) of Rule 14a-8 are applicable. Accordingly, Texaco believes that for purposes of Rule 14a-4, Texaco’s omission of these proposals from its proxy statement should be viewed as being pursuant to Rule 14a-8.”).

⁸⁶ Consolidated Freightways, Inc., SEC No-Action Letter, 1995 WL 100550, at *1 (Mar. 8, 1995) (“Based upon the facts presented, the Division is of the view that Company may in accordance with Rule 14a-4(c)(4), exercise discretionary authority with respect to the shareholder proposals withdrawn by Messrs. Weaver and Boyle. In arriving at this position, the Division has noted that the proposals were originally submitted to the Company pursuant to Rule 14a-8 and that they were withdrawn after the Company submitted its no-action request seeking to omit the proposals under the cited provisions of Rule 14a-8.”).

⁸⁷ Issuers sometimes argued that all proposals should be treated as submitted under Rule 14a-8 for purposes of discretionary authority. Courts, however, rejected the argument. *See* United Mine Workers of Am. v. Pittston Co., No. 89-0962, 1989 WL 201060, at *7 (D.D.C. Nov. 24, 1989) (“The Union’s effort was markedly different from the stringent requirements of Rule 14a-8 to which Pittston asserts all proposals by shareholders are subject. This is an extreme view and Pittston has been unable to supply a single authority to support it. If true, the Court is confident that Pittston would by no means be the first to have defended it. Furthermore, Pittston’s position ignores the essence of the rule and the tradeoff that must be endured when it is

submitted proposals disclaiming reliance on Rule 14a-8 (“Non-Rule 14a-8 Proposals”) were not subject to discretionary authority.⁸⁸ Instead, companies had to disclose the proposal in the proxy materials and provide shareholders with an opportunity to vote on the matter.⁸⁹

In the 1990s, however, the Commission, first by administrative interpretation, then through amendment to the rule, reversed this approach. In *Idaho Power*,⁹⁰ the staff permitted a company to rely on discretionary authority to vote against a Non-Rule 14a-8 Proposal⁹¹ so long as companies “advised” shareholders about the matter⁹² and specified how the shares would be voted.⁹³ Shareholders could only

invoked by shareholders. Rule 14a-8 offers the proponent an opportunity for its proposal to be contained in management’s own proxy statement *at no expense to the proponent*. In return, the proponent must comply with Rule 14a-8’s strictures.”).

⁸⁸ Emerson & Latham, *supra* note 63, at 663 (“The Commission did not adopt the 1948 proposal to modify the X-14A-4(b) provisions with reference to proxies conferring upon a solicitor discretionary authority regarding matters which he knows will be presented at the meeting.”).

⁸⁹ See Schwab & Thomas, *supra* note 20, at 1061–62 (1998) (“If the company is aware of the proposal sufficiently early, then it may choose to include the union’s proposal and supporting statement in the company’s proxy materials, just as it would any shareholder proposal. If the company decides to do this, however, ‘the proposal is likely to get a high vote, comparable to any “normal” shareholder proposal. Albertson’s and Questar handled union proposals this way [in 1996] . . . and the proposals drew support ranging from 21% to 38%.”).

⁹⁰ Idaho Power Co., SEC No-Action Letter, 1996 WL 114545 (Mar. 13, 1996).

⁹¹ See John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 620 (1997) (“A 1996 no-action letter, issued to the Idaho Power Company, is read by some practitioners to authorize the issuer to utilize the discretionary voting authority granted it by the standard proxy, notwithstanding Rule 14a-4, so long as the insurgent’s solicitation is limited and management publicly states how it intends to vote on the issue.”); see also Schwab & Thomas, *supra* note 20, at 1069 (“The SEC recently suggested, however, that management does not always need to include a shareholder floor proposal on the company’s ballot in order to exercise discretionary voting authority.”).

⁹² See Idaho Power Co., SEC No-Action Letter, 1996 WL 114545, at *1 (Mar. 13, 1996) (shareholders must be “advised by the company of the nature of the proposal and how the company intends to vote with respect to the proposal”); see also Borg-Warner Security Corporation, SEC No-Action Letter, 1996 WL 119943, at *1 (Mar. 14, 1996). At least one court indicated that this required disclosure of all “substantive” aspects of the proposal. See *Union of Needletrades, Indust. and Textile Emps. v. May Dep’t Stores Co.*, 26 F. Supp. 2d 577, 581 (S.D.N.Y. 1997) (“The defendant followed the SEC’s recommended procedures by disclosing the substantive aspects of the plaintiffs’ three proposals in May’s original proxy solicitation materials.”), *aff’d*, 171 F.3d 754 (2d. Cir. 1999).

⁹³ See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39093, 1997 WL 578696, at *21 (Sept. 18, 1997) (“Under those no-action letters, a company that receives adequate advance notice of a non-rule 14a-8 proposal—such as under its advance notice bylaw—nevertheless may preserve its discretionary voting authority by disclosing in its proxy materials the nature of any proposal it has been advised may be presented, and the manner in which the company intends to exercise

prevent the use of discretionary authority by engaging in a counter solicitation.⁹⁴

The Commission eventually had second thoughts about the approach and proposed to change the interpretation. Amendments to Rule 14a-4 would have required that companies receiving “adequate notice” of a proposal provide shareholders with the right to withhold discretionary authority.⁹⁵ Moreover, companies were required to include “a discussion of the nature” of any proposal⁹⁶ and provide sufficient information to ensure that shareholders could make an informed decision.⁹⁷

The intended revision engendered substantial opposition. Objections fell into two broad categories. Some focused on the logistical consequences of the approach. Describing the amendment as “troublesome,”⁹⁸ they argued that the change would make the

its discretion.”).

⁹⁴ See Idaho Power Co., *supra* note 90, at *1 (“Assuming Adequate Notice, a company could not, however, exercise discretionary authority under Rule 14a-4(c)(1) with respect to voting on any matter that is the subject of an opposing proxy solicitation so long as the proponent delivers a proxy statement and form of proxy to holders of a majority of the shares entitled to vote on the matter or, if a greater percentage is required under applicable law to carry the proposal, holders of the minimum required. In this circumstance, it is the Division’s view that the matter should be reflected on the company’s proxy card. If not, discretionary authority would not apply to the matter.”). See also Exchange Act Release No. 39093, 1997 WL 578696, at *21 (Sept. 18, 1997) (“Under the no-action letters, the company loses its voting discretion, however, once the proponent commences a proxy solicitation and solicits the percentage of holders required to carry the proposal.”).

⁹⁵ Exchange Act Release No. 39093, 1997 WL 578696, at *22 (Sept. 18, 1997) (“[T]he company would be required to provide shareholders who execute and return proxies an opportunity to withhold discretionary authority, albeit only on those matters for which it received adequate notice and which it described in its proxy statement.”).

⁹⁶ *Id.* (“The new rule would permit the exercise of such authority if the proxy materials include: (i) in the proxy statement, a discussion of the nature of the matters and how the company intends to exercise its discretion on each matter, and (ii) on the proxy card, a cross-reference to the discussion in the proxy statement and a box allowing shareholders to withhold discretionary authority from management to vote on the same matter(s).”).

⁹⁷ *Id.* (“Under that rule, companies must provide shareholders with sufficient information to make informed voting decisions as well as a meaningful opportunity to review the information.”).

⁹⁸ Letter from D. Craig Nordlund, Chairman, Sec. Law Comm., Am. Soc’y of Corp. Sec’y, to Jonathan G. Katz, Sec’y, SEC (Dec. 8, 1997), <http://www.sec.gov/rules/proposed/s72597/nordlund1.htm> [hereinafter Nordlund Letter] (“Although we agree that there needs to be clarification of the rules concerning a company’s discretion to vote uninstructed proxies when a proponent chooses to act outside the scope of rule 14a-8, we find the proposed revision of rule 14a-4 to be especially troublesome.”).

tallying process more complicated.⁹⁹ Others expressed concern over the degree of required disclosure¹⁰⁰ and the difficulty of obtaining the information needed for the proxy statement.¹⁰¹

Most of the comments, however, focused on the ability of shareholders to avoid the limitations contained in Rule 14a-8.¹⁰² Although the rule was never intended to be the exclusive method for making proposals, issuers and their supporters essentially claimed that it was. Bringing proposals directly to the meeting amounted to an “abuse”¹⁰³ and a “back door” around the rule,¹⁰⁴ rendering Rule 14a-8

⁹⁹ Letter from Martin S. Wagner, Assoc. Gen. Counsel, Xerox, Inc., to Jonathan G. Katz, Sec’y, SEC (Nov. 21, 1997), <http://www.sec.gov/rules/proposed/s72597/wagner1.htm> [hereinafter Xerox Letter] (“The addition of the box could create unnecessary complications in the solicitation and proxy counting process.”). *See also* Letter from Alan Bulliner, Assoc. Gen. Counsel, Burlington N. Santa Fe Corp., to Jonathan G. Katz, Sec’y, SEC (Dec. 31, 1997), <http://www.sec.gov/rules/proposed/s72597/morelan1.txt> [hereinafter Burlington N. Santa Fe Letter] (“The Company is concerned that the proposed revision would foist new burdens on companies while at the same time encourage proposals which circumvent the 14a-8 process.”).

¹⁰⁰ Burlington N. Santa Fe Letter, *supra* note 99 (allowing shareholders to withhold discretionary authority for non-rule 14a-8 proposals would cause companies to “feel compelled to provide greater discussion of the non-14a-8 proposal and, as a result, encourage erosion of the entire 14a-8 process”). *See also* Letter from Alan Bulliner, Assoc. Gen. Counsel, Bell Atlantic, to Jonathan G. Katz, Sec’y, SEC (Nov. 13, 1997), <http://www.sec.gov/rules/proposed/s72597/bulline1.txt> [hereinafter Bell Atlantic Letter] (“Also, referencing such a proposal in corporate proxy materials will no doubt result in the inclusion of immaterial proposals at the expense of all shareholders.”).

¹⁰¹ Nordlund Letter, *supra* note 98 (“As proposed, companies would have the burden of providing shareholders with sufficient information to make informed voting decisions. Depending on the sophistication of the proponent and the coherence of communication to the company about the proposal, this could be a difficult or impossible requirement for a company to meet.”).

¹⁰² Nordlund Letter, *supra* note 98 (“We are concerned that under the proposed changes, proponents would have complete flexibility to put matters before shareholders free of all the reasonable requirements and restraints of rule 14a-8. For example, proponents could submit as many proposals as they wish; there would be no minimum share ownership requirement; resubmission thresholds would not apply; and there would be no restriction on the nature of the subject matter that could be presented.”). *See also* Xerox Letter, *supra* note 99 (“The potential effect of the proposed changes in 14a-4 would be to tilt the playing field away from 14a-8 as a way to avoid the criteria of that Rule. Thus, there would be no minimum share ownership requirement, no resubmission thresholds and no restriction on the nature of the subject matter that could be presented.”).

¹⁰³ Burlington N. Santa Fe Letter, *supra* note 99 (“Submission of last minute proposals can be especially vexing as a company finalizes its proxy materials. In recent years, there appears to have been a proliferation of non-14a-8 proposals submitted for tactical or harassment purposes. These efforts to avoid the procedural and substantive requirements of Rule 14a-8 abuse the process.”).

¹⁰⁴ Bell Atlantic Letter, *supra* note 100 (“The problem is that the proposed revision would still permit shareholders to use Rule 14a-4(c) as a back door to force a proxy

“useless.”¹⁰⁵ As one company put it:

Our fear is that this amendment might have the unintended effect of creating two distinct regulatory schemes governing shareholder proposals. Moreover, we are concerned that under the proposed amendments proponents would have the flexibility to choose to ignore the restraints provided in Rule 14a-8. The amended provisions do not limit the number of proposals a single proponent may submit, do not impose a minimum share ownership requirement, do not impose a resubmission threshold requirement, and do not provide any limitations on the subject matter that may be presented. Finally, companies would have the burden of providing information to shareholders sufficient for them to make informed voting decisions. This task might prove impossible, depending on the coherence of the communication by the proponent to the company.¹⁰⁶

Ultimately, the Commission declined to adopt the amendment. The Release ignored shareholder support and instead amended the rule to codify the informal interpretation set out in *Idaho Power*.¹⁰⁷

statement discussion on proposals which an issuer has been advised by counsel are excludable.”). Or as some described, an “end run” around the rule. *See* Letter from Am. Corp. Counsel Ass’n, to Jonathan G. Katz, Sec’y, SEC (Dec. 31, 1997), <http://www.sec.gov/rules/proposed/s72597/manning2.txt> (“In general, we do not believe Rule 14a-4 should be available to shareholders who wish to make an ‘end-run’ around the Rule 14a-8 shareholder proposal process. In this regard, some of the changes proposed to Rule 14a-4(c) would make it both more burdensome for companies to address non-Rule 14a-8 proposals, and would encourage shareholders to bypass the Rule 14a-8 procedures, possibly resulting in more ‘personal’ proposals of little interest to shareholders generally.”). *See also* Letter from Hewlett-Packard Co., to Jonathan G. Katz, Sec’y, SEC (Dec. 23, 1997), <http://www.sec.gov/rules/proposed/s72597/norlund1.htm> (“We are very concerned that the 14a-4 end-run used by many shareholder proponents has created a dual track for shareholder proposals which vitiates the 14a-8 process. The ‘fix’ proposed in the release does not go far enough to fix this problem. In fact, it seems to validate the process by merely pushing back the required notice period.”).

¹⁰⁵ Letter from Jeffrey R. Moreland, Senior Vice President, Burlington N. Santa Fe Corp., to Jonathan G. Katz, Sec’y, SEC (Dec. 31, 1997), <http://www.sec.gov/rules/proposed/s72597/morelan1.txt> (“BNSF believes that, on balance, the proposed revisions to Rule 14a-4 would actually facilitate and encourage 14a-4 proposals. Indeed, the proposed revisions, if adopted, might encourage proponents whose 14a-8 proposals have been excluded to resubmit them under 14a-4.”).

¹⁰⁶ Letter from Diane A. Ward, Senior Counsel, Atl. Richfield Co., to Jonathan G. Katz, Sec’y, SEC (Nov. 24, 1997), <https://www.sec.gov/rules/proposed/s72597/ward1.txt>.

¹⁰⁷ As one shareholder stated: “CalPERS does not believe that company management needs this advantage, particularly when the proponent has not chosen to impose upon the company the cost of distributing its proposal through submission

Companies could obtain discretionary authority to vote against Non-Rule 14a-8 proposals so long as shareholders received adequate disclosure.¹⁰⁸ In doing so, the Commission reasoned that shareholders benefited by avoiding “confusing” proxy cards.¹⁰⁹

The final rule included only one exception. Discretionary authority could not be used where companies were notified of a counter-solicitation.¹¹⁰ Nonetheless, the rule made the exception difficult to use. Shareholders had to agree to deliver a proxy statement and proxy card to at least “the percentage of the company’s voting shares required under applicable law to carry the proposal,”¹¹¹ an apparent attempt to overturn existing shareholder practices.¹¹² Moreover, to alleviate an issuer “dilemma,”¹¹³ the rule required the

under Rule 14a-8. Most companies have the ability to amend their bylaws to require advance notice of matters to be presented from the floor, should they believe this notice is truly necessary. This is an area where Commission action is not necessary.” Letter from Kayla Gillan, Gen. Counsel, Calpers, to Jonathan G. Katz, Sec’y, SEC (Nov. 10, 1997), <https://corpgo.fatcow.com/calpers/CalPERS14a-8comments.html>.

¹⁰⁸ The Commission also retreated on the degree of disclosure required when invoking discretionary authority. Rather than require a “discussion” of the non-14a-8 proposal, the standard set out in the proposing release, companies only had to “advise” shareholders of the impending proposals. The final rule simply included a reminder of the impact of the antifraud provisions. Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40018, 1998 WL 254809, at *7 (May 21, 1998) (“We remind you that the disclosure prescribed by amended rule 14a-4(c)(2), as with any disclosure item, must take into account the disclosure requirements of the proxy anti-fraud rule.”).

¹⁰⁹ *Id.* (“Some stated that a voting box permitting shareholders to withhold discretionary voting authority in some circumstances may be confusing if shareholders are also independently solicited by the proponent in support of the same proposal. We agree that inclusion of the proposed box on companies’ proxy cards may be confusing in some circumstances.”).

¹¹⁰ *Id.* at *8 (“The final rule therefore precludes a company from exercising discretionary voting authority on matters as to which it has received adequate advance notice if the proponent provides the company as part of that notice with a statement that it intends to solicit the percentage of shareholder votes required to carry the proposal, followed with specified evidence that the stated percentage had actually been solicited.”).

¹¹¹ See SEC Solicitation of Proxies, 17 C.F.R. § 240.14a-4(c)(2)(i) (2012). The adopting release suggests that the solicitation must be for a “significant percentage” of the outstanding shares. As a practical matter, however, a precatory proposal will be adopted when receiving a majority of the shares cast on the matter. As a result, there is no fixed percentage of outstanding shares required to approve a precatory proposal.

¹¹² Coffee, *supra* note 91, at 619–21 (“A preferred tactic appears to be to rely not on Rule 14a-8, but instead to file an actual proxy solicitation covering the proposed bylaw amendment and then only solicit a limited number of shareholders in order to avoid unnecessary expense.”).

¹¹³ Amendments to Rules on Shareholders Proposals, Securities Exchange Act Release No. 39093, 1997 WL 578696, at *21 (Sept. 18, 1997) (“For instance, if the shareholder proponent files preliminary proxy materials after the company has filed its own proxy statement, or even after the company has mailed its definitive proxy

submission of the written notification¹¹⁴ well before the commencement of the solicitation process.¹¹⁵

IV. PREVENTING THE EXERCISE OF DISCRETIONARY AUTHORITY

The amendments adopted in 1998 effectively ended any pretense that the proxy rules duplicated rather than restricted the rights of shareholders exercisable at the meeting. Discretionary authority could be used to vote against proposals made at the meeting that were unknown to management. Discretionary authority could be used to vote against proposals made at the meeting but “omitted” under Rule 14a-8. Finally, discretionary authority could be used to vote against proposals made at the meeting that were known to management so long as shareholders were provided “advice on the nature of the matter.”¹¹⁶

The proxy card was not required to offer a mechanism for preventing the transfer of discretionary authority. Transfer could only be blocked by withholding of the proxy card. The failure to return a proxy card, however, came at a cost. Shareholders either had to physically attend the meeting and cast a ballot or entirely forego their voting rights.

Particularly in the case of institutional investors, the option of not voting raised potential legal concerns. The decision could conflict with their fiduciary obligations.¹¹⁷ At the same time, however, actual attendance was, for the most part, an unacceptable alternative. For

statement and form of proxy to shareholders, the company may be placed in a dilemma of either including the shareholder’s proposal on its proxy card, or risking the delay and expense of a last-minute resolicitation. That is because the company may not know whether the shareholder intends to begin to solicit proxies independently by circulating his/her own proxy card, along with the definitive version of his or her proxy statement, or how many shareholders will be solicited if such a solicitation is actually launched.”).

¹¹⁴ Thus, knowledge that a counter-solicitation was likely would not be enough to prevent the exercise of discretionary authority if not submitted in writing. See Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporate Corporate Governance Analysis into First Amendment Jurisprudence*, 79 WASH. U. L. Q. 1, 55 n.328 (2001) (“Even if management has reason to know that dissident shareholders may subsequently launch an independent anti management proxy solicitation, management can retain discretionary authority by disclosing its knowledge and intent to use its discretionary authority to vote against dissident proposals if they are made.”).

¹¹⁵ See 17 C.F.R. § 240.14a-4(c)(2)(i) (2012) (requiring written notice at least forty-five days before the date proxy materials were solicited the prior year or the date specified in an advance notice bylaw).

¹¹⁶ Rule 14a-4(c)(2), 17 C.F.R. § 240.14a-4(c)(2) (2012).

¹¹⁷ See SEC Staff Legal Bulletin No. 20, 2014 WL 2965312, at *1 (June 30, 2014) (“As a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to services undertaken on the client’s behalf, including proxy voting.”).

one thing, the shareholder would need to travel to the meeting site, an obvious expense.¹¹⁸ Attendance also presented opportunity costs. The time could be spent doing something else more useful.

For investors with broad portfolios, actual attendance also raised serious logistical impediments. Annual meetings for public companies are bunched over a short period of time. In 2013, almost seventy percent of the companies in the Fortune 500 and Russell 3000 held their meetings in April, May, and June.¹¹⁹ As a result, pension plans and mutual funds could find themselves needing to vote in hundreds, if not thousands, of meetings in a compacted period of time. Attendance at all or most of the meetings would be practically impossible.

Nor were these the only difficulties. For the most part, shareholders held their investments not as record owners¹²⁰ but in street name accounts.¹²¹ Shares were purchased through an account at a broker and titled in the name of a depository. During the meeting process, the depository executed an omnibus proxy and transfers voting rights to the brokers.¹²² As a result, brokers, not street name owners, received the proxy cards and returned them to the company, thereby providing management with discretionary authority.¹²³

Street name owners seeking to avoid the transfer of discretionary

¹¹⁸ To the extent the company held a virtual meeting, physical attendance would be unnecessary. Shareholders would still, however, incur the opportunity costs associated with attendance. See Coffee, *supra* note 91, at 620 (“Clearly, attendance at the shareholder meeting in person in order to vote is too costly an alternative.”).

¹¹⁹ See J. ROBERT BROWN, JR. & LISA CASEY, CORPORATE GOVERNANCE 455–56 (2d ed. 2016).

¹²⁰ Direct registration provides a mechanism for ensuring that shareholders are given record title to shares. See Transfer Agent Regulations, Exchange Act Release No. 76743, 2015 WL 9311555, at *14 (Dec. 22, 2015) (“In 1996, the Direct Registration System (“DRS”) was implemented, which allowed investors to hold uncertificated securities in registered form directly on the books of the issuer’s transfer agent.”). The DRS allows investors to “retain the rights of registered owners, without having the responsibility of holding and safeguarding securities certificates.” Concept Release on the U.S. Proxy System, Exchange Act Release No. 62495, 2010 WL 2779423 (July 14, 2010). As a result, shareholders holding shares in this manner would receive a proxy card directly from the company and need not obtain a proxy from the broker.

¹²¹ Transfer Agent Regulations, Exchange Act Release No. 76743, 2015 WL 9311555, at *16 (“The vast majority of security holders in the U.S. are beneficial owners rather than registered owners.”).

¹²² For a discussion of this system of ownership, see J. Robert Brown, Jr., *The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. CORP. L. 683 (1988) [hereinafter Brown, *The Shareholder Communication Rules*].

¹²³ Before returning the proxy card to the company, brokers solicit voting instructions from street name owners. See Brown, *The Shareholder Communication Rules*, *supra* note 122, at 704.

authority must first reclaim from the broker the voting power for their shares.¹²⁴ Broadridge, the agent typically used by brokers in connection with the proxy distribution process, allows street name owners to obtain a “legal” proxy.¹²⁵ The process results in the broker appointing the street name owner as the agent to vote the shares.¹²⁶ The broker also must notify the company “of the number of proxies sent to customers and the identifying numbers and shares represented by such proxies.”¹²⁷

Once in possession of the “legal” proxy, street name owners can prevent the transfer of discretionary voting authority. They may decline to return the card, causing the shares not to be present at the meeting for voting purposes. Alternatively, they may attend the meeting and vote by ballot.¹²⁸ The process of obtaining a “legal” proxy and voting at the meeting has been described as “cumbersome and expensive.”¹²⁹

¹²⁴ Exchange Act Release No. 29340, 2010 WL 2779423, at *8 n.50 (“Beneficial owners may, however, request a proxy and attend the shareholder meeting. It is our understanding that both banks and broker-dealers will issue a proxy that the beneficial owner may use to attend a meeting if requested to do so.”).

¹²⁵ For a version of the “legal proxy,” see Sample Legal Proxy, MATERIALS.PROXYVOTE.COM, https://materials.proxyvote.com/Approved/EPLST1/20100210/OTHER_52009/PDF/broadridge-cis2010_0059.pdf. The legal proxy includes the CUSIP number for the relevant class of shares, the number of shares, and the identity of the street name owner. See NYSE Rule 451.30, http://nyserules.nyse.com/nysetools/PlatformViewer.asp?SelectedNode=chp_1_2&manual=/nyse/rules/nyse-rules/ (setting out procedures for sending signed proxies to customers, including “a code number for identification and the exact number of shares held of record for the account of the customer” and “appropriate instructions”).

¹²⁶ Broadridge will subtract any shares subject to a “legal” proxy from the total number of shares held by the broker. See Email from Chuck Callan, Senior Vice President Regulatory Affairs, Broadridge, Fin. Sols., Inc., to author (Feb. 3, 2016, 6:38 MT) (on file with the author).

¹²⁷ NYSE Rule 451.30(3), http://nyserules.nyse.com/nysetools/PlatformViewer.asp?SelectedNode=chp_1_2&manual=/nyse/rules/nyse-rules/. The information does not include the identity of the beneficial owner. As a result, the broker is obligated to send a follow up communication to encourage return of the proxy upon the request of the issuer. *Id.* at 451.30(4).

¹²⁸ Internet Availability of Proxy Materials, Exchange Act Release No. 52926, 2005 WL 3610280, at *10 n.57 (Dec. 8, 2005) (“A beneficial owner could execute a proxy directly if the intermediary (the holder of record) has appointed the beneficial owner as its proxy with respect to the beneficial owner’s shares.”).

¹²⁹ Letter from Glenn Davis, Dir. of Research, Council of Institutional Inv’rs, to Elizabeth Murphy, Sec’y, SEC (Jan. 8, 2014), <https://www.sec.gov/rules/petitions/2014/petn4-672.pdf>. (“The only tested and certain way for a shareholder to vote freely for his or her individually preferred combination of director candidates is to attend the meeting in person—obtaining a

V. THE LIMITATIONS IMPOSED ON SHAREHOLDERS: A CASE STUDY

For the most part, companies cannot obtain discretionary authority to vote on matters set out in the proxy statement and proxy card.¹³⁰ Shareholders planning to raise matters at the meeting, therefore, have an incentive to invoke Rule 14a-8 and seek to include the proposal in the company's proxy statement. This is not, however, always possible. The Commission has interpreted the requirements of the rule to summarily exclude certain substantive topics otherwise important to investors.

A. Auditor Qualifications

A critical example of this categorical approach involves the exclusion of proposals relating to the selection or qualification of the independent auditor. The importance of auditors and auditor independence to investors is widely recognized.¹³¹ As one Commissioner at the SEC described: "When an investor puts money into a far off corporate enterprise, the auditor is an independent accounting professional who serves as the eyes and ears of the investor."¹³²

Despite the importance of the relationship, the staff of the Commission has categorically allowed for the exclusion of almost every proposal addressing auditors. In a misreading of the "ordinary

'legal proxy' from the broker if the shareholder holds its shares in 'street name' and is not the record holder—and vote on the manual ballots distributed. This is a cumbersome and expensive process that only the most sophisticated and deep-pocketed shareholders understand and may consider pursuing.”)

¹³⁰ They do have the right to vote on matters left blank in the proxy card. *See supra* Section III.A.

¹³¹ *See, e.g.,* SEC v. Transamerica Corp., 163 F.2d 511, 516–17 (3d Cir. 1947) (“[T]he auditing of the books of a corporation is a proper subject for stockholder consideration and action. Surely the audit of a corporation's books may not be considered to be peculiarly within the discretion of the directors. A corporation is run for the benefit of its stockholders and not for that of its managers.”).

¹³² Kara M. Stein, SEC, Accountants and Capital Markets in an Era of Digital Disruption, Remarks at the Institute of Chartered Accountants in England and Wales and BritishAmerican Business (Sept. 9, 2015) (transcript available at <https://www.sec.gov/news/speech/remarks-inst-chartered-acctnts.html>). *See also* Daniel L. Goelzer, Bd. Member, Pub. Co. Accounting Oversight Bd., Sarbanes-Oxley and the Post-Enron Era, Address at Columbia University Law Center, Center for Japanese Legal Studies (Aug. 2, 2005) (transcript available at https://pcaobus.org/News/Speech/Pages/08022005_GoelzerSOXAuditorOversight.aspx) (“Unlike other gatekeepers, it has always been recognized, at least in theory if not always in practice, that the auditor has important obligations to the investing public that may require him or her to act contrary to the interests of the client. . . . Fundamentally, the Sarbanes-Oxley Act seeks to refocus auditor[s] on their obligations to public shareholders.”).

business” exclusion,¹³³ proposals have been omitted that relate to the “method of selecting the auditor”¹³⁴ or “more generally” proposals that relate to the “management of the independent auditor’s engagement”¹³⁵

As a result, the Commission has permitted the exclusion of proposals addressing auditor rotation, irrespective of the period of time involved.¹³⁶ The same is true for proposals requesting changes to

¹³³ SEC Solicitation of Proxies, 17 C.F.R. § 240.14a-8(i)(7) (2012). Indeed, when adopting the exclusion in subsection (i)(5), or matters not significantly related to a company’s business, the Commission described shareholder ratification as a “traditional shareholder proposal[]” Solicitations of Proxies, Exchange Act Release No. 9784, 1972 WL 125400, at *2 (Sept. 22, 1972) (“Also, the provision is not intended to serve as a basis for the omission of traditional shareholder proposals dealing with stockholder relationships with the management, such as cumulative voting, annual meetings, and ratification of auditors, since all these matters can be considered significantly related to the issuer’s business or within its control.”).

¹³⁴ The phrase was first used in 2001. See *SONICblue Inc.*, SEC No-Action Letter, 2001 WL 306189, at *9 (Mar. 23, 2001) (describing exclusion of proposal requesting “that the board of directors have the auditor selected annually by shareholder vote” under (i)(7) as relating to “the method of selecting independent auditors”).

¹³⁵ The phrase first appeared in 2010. See *Masco Corp.*, SEC No-Action Letter, 2010 WL 4922393, at *1, *4 (Jan. 13, 2010) (excluding proposal requesting that board “adopt a resolution requiring that Masco limit the term of engagement of its independent auditors to a maximum of five years” as relating “to limiting the term of engagement of Masco’s independent auditors,” and noting that “[p]roposals concerning the selection of independent auditors or, more generally, management of the independent auditor’s engagement, are generally excludable under rule 14a-8(i)(7)”). The phrase now routinely appears in no action letters relating to auditors. See, e.g., *JPMorgan Chase & Co.*, SEC No-Action Letter, 2010 WL 147300 (Mar. 5, 2010); *Deere & Co.*, SEC No-Action Letter, 2011 WL 4551548 (Nov. 18, 2011); *U.S. Bancorp*, SEC No-Action Letter, 2011 WL 5998983 (Dec. 16, 2011); *Stanley Black & Decker, Inc.*, SEC No-Action Letter, 2011 WL 5927450 (Dec. 15, 2011); *The Walt Disney Co.*, SEC No-Action Letter, 2011 WL 5187234 (Nov. 23, 2011).

¹³⁶ See *Pac. Gas & Elec. Co.*, SEC No-Action Letter, 1991 WL 176503, at *1 (Jan. 18, 1991) (providing that the company “shall hire a new and different accounting firm starting the four year period” as relating to “the method and criteria used to determine the independent auditor selected”); see also *S. New England Telecomm. Co.*, SEC No-Action Letter, 1991 WL 178481 (Feb. 11, 1991); *ConAgra Foods, Inc.*, SEC No-Action Letter, 2002 WL 1334815 (June 14, 2002); *Bank of Am. Corp.*, SEC No-Action Letter, 2003 WL 40624 (Jan. 2, 2003); *The Allstate Corp.*, SEC No-Action Letter, 2003 WL 360106 (Feb. 5, 2003); *Am. Fin. Gr., Inc.*, SEC No-Action Letter, 2002 WL 1058529 (Apr. 4, 2002). See also Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1, 4, 189 (1992) (“In addition, while shareholders routinely vote at annual meetings on auditors, they cannot, under the ordinary business exclusion, suggest other auditors or even recommend that auditors be rotated from time to time.”).

the auditor,¹³⁷ the adoption of specified qualifications,¹³⁸ or the development of data on “auditor reputation.”¹³⁹ Exclusion has also been permitted of proposals seeking a “justification for the retention of the same audit firm”¹⁴⁰ or “information about the company’s policies or practices of periodically considering audit firm rotation. . . .”¹⁴¹ Proposals seeking information on the “financial capacity” of the auditor were likewise excluded.¹⁴² Efforts to obtain reconsideration of

¹³⁷ Refac, SEC No-Action Letter, 2002 WL 834233, at *1 (Mar. 27, 2002) (requesting that “the board take the necessary steps to change the public accounting firm engaged for the annual independent audit and to amend and improve corporate disclosure practices” as relating to the “changing the current auditor” and the disclosure of ordinary business matters”).

¹³⁸ Comty. Bancshares, Inc., SEC No-Action Letter, 1999 WL 166982, at *1–2 (Mar. 15, 1999) (commenting on proposal seeking to amend “the bylaws to require that the independent auditor be a regional or national certified public accounting firm and that the audit committee consist of independent directors” excluded under (i) (7) as relating to the “selection and qualification of auditors” with letter stating that “[w]e note in particular that the Wittmeier proposal requires the independent auditor be a regional or national certified accounting firm”).

¹³⁹ Cleveland-Cliffs Inc., SEC No-Action Letter, 2003 WL 942982, at *1 (Mar. 4, 2003) (stating exclusion of proposal requesting that the “board of directors to conduct an annual, shareholder poll of auditor reputation and release the results of the poll to the news media” under (i) (7) as relating to “the company’s selection of independent auditors”); USG Corp., SEC No-Action Letter, 2003 WL 942651, at *1 (Mar. 5, 2003) (stating exclusion of proposal requesting that the “board of directors to conduct an annual, shareholder poll of auditor reputation and release the results of the poll to the news media” under (i) (7) as relating to “the company’s selection of independent auditors”).

¹⁴⁰ Gen. Elec. Co., SEC No-Action Letter, 2003 WL 292179, at *1 (Jan. 28, 2003) (stating exclusion of proposal requesting that “the Board of Directors require the audit committee to include in its committee report and recommendation: (1) the number of consecutive years of service by the independent auditor and (2) if in excess of five consecutive years, a clear justification for the retention of the same audit firm for such extended period” under (i) (7) as relating to the “disclosure of the method of selecting independent auditors”); *see also* Loews Corp., SEC No-Action Letter, 2003 WL 292196, at *1 (Jan. 28, 2003).

¹⁴¹ Comp. Scis. Corp., SEC No-Action Letter, 2012 WL 1119677, at *1 (May 3, 2012) (containing a proposal requesting “that the board audit committee prepare and disclose to shareholders an annual ‘Audit Firm Independence Report’” that included “information about the company’s policies or practices of periodically considering audit firm rotation, seeking competitive bids from other public accounting firms for audit engagement, and assessing the risks that may be posed to the company by the long-tenured relationship of the audit firm with the company,” with the staff noting that proposals “concerning the selection of independent auditors or, more generally, management of the independent auditor’s engagement”); *see also* McKesson Corp., SEC No-Action Letter, 2012 WL 1023667 (May 3, 2012); Xilinx, Inc., SEC No-Action Letter, 2012 WL 812910 (May 3, 2012); CA, Inc., SEC No-Action Letter, 2012 WL 1574702 (May 3, 2012); Dell, Inc., SEC No-Action Letter, 2012 WL 748852 (May 3, 2012); NetApp, Inc., SEC No-Action Letter, 2012 WL 1549852 (May 10, 2012).

¹⁴² Occidental Petroleum Corp., SEC No-Action Letter, 1998 WL 17930, at *1 (Jan. 13, 1998) (allowing for the exclusion of a proposal requesting “that the board provide

this approach by the staff has not proved successful.¹⁴³

The proposals have been excluded despite the public policy implications of the topic.¹⁴⁴ At least since the demise of Enron, the role of auditors as gatekeepers for shareholders has been a much debated topic. The Sarbanes-Oxley Act (“SOX”), legislation designed to address the concerns arising out of the Enron crisis, created the Public Company Accounting Oversight Board (“PCAOB”) to oversee auditors.¹⁴⁵ With respect to auditor rotation, SOX mandated a study of the practice¹⁴⁶ and the PCAOB conducted an extensive examination of the matter.¹⁴⁷ The European Union also imposed mandatory rotation requirements on some public companies.¹⁴⁸

certain information about the financial capacity of the Company’s auditors” under (c)(7) as relating to “the selection of independent auditors”); LTV Corp., SEC No-Action Letter, 1998 WL 817825 (Nov. 25, 1998). *See also* LTV Corp., SEC No-Action Letter, 1996 WL 741751, at *1 (Dec. 30, 1996) (allowing for the exclusion of a proposal seeking a “report on the financial capacity of its independent auditors to pay claims for malpractice, negligence or fraud” as relating to “the company’s selection”); Occidental Petroleum Corp., SEC No-Action Letter, 1997 WL 33767 (Jan. 22, 1997).

¹⁴³ Likewise, reconsideration of the exclusion of proposals calling for increased disclosure failed. In Computer Sciences Corporation, shareholders sought reconsideration of a proposal that sought to require disclosure of an Audit Firm Independence Report, a report that among other things called for disclosure of board policies with respect to audit rotation. Comput. Scis., Corp., SEC No-Action Letter, 2012 WL 2410961 (June 26, 2012). Shareholders argued that the information was important to investors when approving auditors and electing directors. *Id.* at *4 (“There are two shareholder voting contexts in which the information requested in the Proposal’s Independence Report is critically important: the election of directors and the ratification of the selection of the external audit firm.”). Reconsideration, however, was denied. *Id.* at *1 (“On May 3, 2012, we issued our response expressing our informal view that Computer Sciences could exclude the proposal from its proxy materials for its upcoming annual meeting. You have asked us to reconsider our position. After reviewing the information contained in your letter, we find no basis to reconsider our position.”).

¹⁴⁴ The proposals were typically excluded under the “ordinary business” exclusion contained in Rule 14a-8(i)(7). The exclusion, however, does not apply to matters of important public policy. *See* Adrien Anderson, *The Policy of Determining Significant Policy under Rule 14A-8(i)(7)*, 93 DENV. L. REV. ONLINE 183 (2016).

¹⁴⁵ *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101, 116 Stat. 745 (2002), http://pcaobus.org/About/History/Documents/PDFs/Sarbanes_Oxley_Act_of_2002.pdf.

¹⁴⁶ *See id.* § 207.

¹⁴⁷ *See* U.S. GOV’T ACCOUNTABILITY OFF., GAO-04-216, PUBLIC ACCOUNTING FIRMS: REQUIRED STUDY ON THE POTENTIAL EFFECTS OF MANDATORY AUDIT FIRM ROTATION (2003).

¹⁴⁸ *See* European Commission Press Release IP/14/104, European Parliament backs Commission proposals on new rules to improve the quality of statutory audit (Apr. 3, 2014), http://europa.eu/rapid/press-release_STATEMENT-14-104_en.htm (“Public-interest entities will be required to change their statutory auditors after a maximum engagement period of 10 years. Member States can choose to extend the 10-year period up to 10 additional years if tenders are carried out, and by up to 14

B. Auditor Ratification

The approach taken with respect to auditor proposals was not always so categorical. This was the case, for example, with respect to proposals seeking the authority to ratify the auditor. As a matter of governance, most companies, while not legally required, commonly provide shareholders with the right to vote on the outside accounting firm.¹⁴⁹ In connection with the minority of public companies that did not, shareholders sometimes submitted proposals under Rule 14a-8 requesting the authority.¹⁵⁰

Efforts to exclude these proposals were initially unsuccessful.¹⁵¹ By the new millennium, however, the position changed.¹⁵² The

additional years in case of joint audit, i.e. if the audited company appoints more than one audit firm to carry out its audit. Calibrated transitional periods taking into account the duration of the audit engagement are also foreseen to avoid a cliff effect once the new rules apply.”).

¹⁴⁹ See J. Robert Brown, Jr., *The Politicization of Corporate Governance: Bureaucratic Discretion, the SEC and Shareholder Ratification of Auditors*, 2 HARV. BUS. L. REV. 501, 518 (2012) [hereinafter Brown, *Politicization of Corporate Governance*] (“Since the 1930s, shareholders have routinely been given the right to ratify a company’s auditors.”).

¹⁵⁰ Possible Revisions to Audit Committee Disclosures, Exchange Act Release No. 75344, 2015 WL 3982031, at *8 (July 1, 2015) (“While the audit committees of listed issuers are required to appoint the issuer’s auditors, many issuers solicit the approval or ratification of the independent auditors from shareholders.”) (citing *Audit Committee Reporting to Shareholders: Going Beyond the Minimum*, ERNST & YOUNG (Feb. 2013), [http://www.ey.com/Publication/vwLUAssets/Audit_committee_reporting_to_shareholders%3A_going_beyond_the_minimum/\\$FILE/Audit_committee_reporting_CF0039.pdf](http://www.ey.com/Publication/vwLUAssets/Audit_committee_reporting_to_shareholders%3A_going_beyond_the_minimum/$FILE/Audit_committee_reporting_CF0039.pdf) (noting that more than 90 percent of Fortune 100 companies seek annual shareholder ratification of the auditor chosen by the audit committee)).

¹⁵¹ Capital Cities/ABC, Inc., SEC No-Action Letter, 1987 WL 107815, at *1 (Mar. 23, 1987) (not allowing for the exclusion of proposal seeking to have “the shareholders elect the Company’s independent auditors annually” under subsection (c)(7)). The position was not surprising. The Commission had previously acknowledged the “significance” of the issue to shareholders. See Proposed Amendments to Rule 14(a)-8 under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders (S7-643), Exchange Act Release No. 12598, 1976 WL 160410, at *7 (July 7, 1976) (“[P]roposals dealing with cumulative voting rights or the ratification of auditors may not be economically significant to an issuer’s business, but they nevertheless have a significance to security holders that would preclude their being omitted under this provision.”). Moreover, commentators noted in a matter of fact way the right of shareholders under state law to vote on the auditor. See Milton V. Freeman, *An Estimate of the Practical Consequences of the Stockholder’s Proposal Rule*, 34 U. DET. L.J. 549 (1957) (“A shareholder always could stand up at a stockholders meeting and make a motion that in the future the meeting should be held in some other city, that the auditors should be elected by stockholders rather than selected by the directors alone, etc.”).

¹⁵² See SONICblue, *supra* note 134; see also Fleetwood Enters., Inc., SEC No-Action Letter, 2002 WL 32078264, at *1 (Apr. 24, 2002) (discussing exclusion of proposal requesting “that Fleetwood select its independent auditor annually by shareowner vote” under (i)(7) as relating to “the method of selecting independent auditors”). One earlier letter did permit the exclusion of a proposal calling for shareholder

Commission did so without reference to the contrary precedent and without an explanation for the shift in position.¹⁵³ The change also discounted the public policy implications of the issue¹⁵⁴ and the

approval of the auditor. *See* Excalibur Techs. Corp., SEC No-Action Letter, 1998 WL 234151, at *1–2 (May 4, 1998). The facts, however, were somewhat unique. In Excalibur Techs. Corp., the shareholder submitted a proposal requesting that the “appointment of the Company’s independent auditors be subject to approval by the shareholders at the annual meeting.” The company argued that an appointment by shareholders would lock the company into a choice that might not be in the best interests of shareholders. *Id.* Subsequent proposals would focus on ratification rather than appointment. *See infra* note 153.

¹⁵³ Paccar, Inc., SEC No-Action Letter, 2004 WL 111635, at *1 (Jan. 14, 2004) (proposal requesting “that the board of directors adopt a policy that the company’s independent auditor be submitted to shareholder ratification” under (i) (7) as relating to “the method of selecting independent auditors”); HRPT Props. Tr., SEC No-Action Letter, 2004 WL 224449 (Jan. 28, 2004); USG Corp., SEC No-Action Letter, 2004 WL 224463 (Jan. 28, 2004); Cousins Props. Inc., SEC No-Action Letter, 2004 WL 334466 (Feb. 17, 2004); Xcel Energy Inc., SEC No-Action Letter, 2004 WL 224479 (Jan. 28, 2004); Apache Corp., SEC No-Action Letter, 2004 WL 224450 (Jan. 25, 2004); Wendy’s Int’l, Inc., SEC No-Action Letter, 2004 WL 224543 (Jan. 25, 2004).

¹⁵⁴ Auditor ratification has been a much debated topic. With respect to auditor ratification, a report from an advisory committee at the Department of the Treasury recommended that shareholders in all companies have the authority. *See* U.S. DEP’T OF TREASURY, FINAL REPORT OF THE ADVISORY COMMITTEE ON THE AUDITING PROFESSION 20 (2008). Calstrs petitioned the SEC to amend Rule 10A-3 to require shareholder ratification of auditors. *See* Letter from Christopher Ailman, Chief Inv. Officer, Cal. State Teachers’ Ret. Sys. Invs., to Florence E. Harmon, Acting Sec’y, SEC (Sept. 23, 2008), <https://www.sec.gov/rules/petitions/2008/petn4-570.pdf>. Given the importance of the ratification issue, calls have arisen to bar brokers from voting uninstructed shares in connection with auditor approval. Letter from Brandon J. Rees, Deputy Dir., AFL-CIO, to Brent J. Fields Sec’y, SEC (Sept. 8, 2015), <https://www.sec.gov/comments/s7-13-15/s71315-73.pdf> (“To make these votes a more meaningful reflection of shareholder views, the SEC should also prohibit discretionary voting on auditor ratification by brokers for their clients’ uninstructed shares as is currently permitted by NYSE Rule 452.”). Perhaps most noticeably, the need for improved disclosure in connection with shareholder ratification of the auditor has been widely recognized, including by the Commission. In a concept release, issued in 2015, the Commission noted the shortcomings of the current disclosure regime and acknowledged “investors and other stakeholders have requested greater transparency about audit committee activities.” Possible Revisions to Audit Committee Disclosures, Exchange Act Release No. 75344, 2015 WL 3982031, at *8 (July 1, 2015) (“The rules do not require issuers to provide information about the audit committee’s process and reasons that lead to the selection of the independent auditor subject to the ratification solicitation.”) The release recognized the “public interest” in the “subject of auditor tenure” and sought “feedback” to better understand the types of disclosure that would be useful to investors. *Id.* at *9 (“Providing additional disclosure about the audit committee’s oversight of the independent auditor could further inform investors about the oversight process and provide them with useful context for audit committee decisions. It may also enable investors to differentiate between companies based on the quality of audit committee oversight, and determine whether such differences in quality of oversight may contribute to differences in performance or quality of financial reporting among companies.”).

importance of the matter to shareholders.¹⁵⁵ It took only a few years before the exclusion of ratification proposals became routine.¹⁵⁶ Efforts to convince the Commission to intervene and reverse the position were unsuccessful.¹⁵⁷

VI. ANALYSIS

Auditor related proposals demonstrate the limitations imposed on shareholder voting rights under the proxy rules. Because of their subject matter, the proposals are subject to a categorical exclusion

¹⁵⁵ Only one meaningful exception to the categorical exclusion of auditor proposals has apparently been made, arising from the deemed importance of the subject to the public. In Safeway, Inc., SEC No-Action Letter, 2002 WL 398743, at *1 (February 26, 2002), shareholders requested that the board adopt a policy “that in the future the firm that is appointed to be the Company’s independent accountants will only provide audit services to the Company and not provide any other services.” The no action relief was not granted given “the widespread public debate concerning the impact of non-audit services on auditor independence and the increasing recognition that this issue raises significant policy considerations.” *Id.* See also V.F. Corp., SEC No-Action Letter, 2002 WL 500196, at *1 (March 7, 2002) (refusing to allow exclusion of proposal requesting that the board adopt a policy “that the public accounting firm retained by our Company to provide audit services, or any affiliated company, should not also be retained to provide non-audit-services to our Company” and noting “the widespread public debate concerning the impact of non-audit services on auditor independence and the increasing recognition that this issue raises significant policy considerations”).

¹⁵⁶ Toys “R” Us, Inc., SEC No-Action Letter, 2005 WL 448213, at *1 (Feb. 22, 2005) (excluding proposal that requests the “board of directors adopt a policy that the company’s independent auditor be submitted to shareholder ratification” under (i)(7) as relating to “the method of selecting independent auditors”); Qwest Commc’ns Int’l Inc., SEC No-Action Letter, 2005 WL 484382 (Feb. 23, 2005); Xcel Energy Inc., SEC No-Action Letter, 2005 WL 484394 (Feb. 23, 2005). See also Brown, *Politicization of Corporate Governance*, *supra* note 149, at 525 (“Despite the longstanding and consistent position of the SEC, the staff unexpectedly concluded, without analysis or explanation, that the proposal could be omitted under the ordinary business’ exclusion. The public importance of the debate over auditor independence received no mention. In quick order, the position was repeated in other No-Action letters. By 2005, companies routinely received relief authorizing the exclusion of these sorts of proposals.”).

¹⁵⁷ The New York City Pension Funds submitted a number of proposals seeking shareholder ratification of the auditor. In Rite Aid, the Commission concluded that the matter related to the “method of selecting independent auditors.” Rite Aid Corp., SEC No-Action Letter, 2006 WL 871029, at *1 (Mar. 31, 2006). The Funds appealed the decision, noting that the earlier letters had allowed for the exclusion of auditor ratification proposals “without the benefit of any proponent opposition.” *Id.* Among other things, the shareholder emphasized a speech made by the chair of the SEC that emphasized “the need for auditor independence.” *Id.* Reconsideration, however, was denied and the matter not presented to the Commission. See Brown, *Politicization of Corporate Governance*, *supra* note 149, at 526 (“Again without explanation, the staff denied the appeal and reaffirmed that auditor selection fell within the ‘ordinary business’ exclusion. The action suggested acquiescence by the Commission in the staff’s revised interpretation.”).

from the proxy statement. The only alternative for shareholders wanting to debate auditor related issues is to avoid Rule 14a-8 and raise the matter directly at the meeting. Management, however, can use the proxy process to obtain the discretionary authority necessary to ensure the defeat of the proposal, preventing shareholders from providing their collective views on the matter.

Rule 14a-4 reflects a microcosm in the development of the proxy rules. The proxy rules began with the laudatory purpose of ensuring that shareholders received the same rights as those exercisable at the meeting.¹⁵⁸ The evolution of the proxy rules has reflected the interests of issuers¹⁵⁹ because shareholders are poorly organized and, at least initially, show limited interest in governance reform.¹⁶⁰ The practice, therefore, was to develop rules that restricted rather than duplicated the rights of shareholders.

This approach can be seen with respect to the development of Rule 14a-4. What ought to have been a highly technical but neutral rule designed to ensure the proper exercise of voting authority has evolved into a vehicle for limiting voting rights. A proxy card does not provide the same choices as a ballot distributed at the meeting.¹⁶¹ The obligation of impartiality additionally remains unenforced,¹⁶² with

¹⁵⁸ See *Hearings on H.R. 1493*, *supra* note 3.

¹⁵⁹ The involvement of shareholders in the evolution of the proxy rules increased in the new millennium. See Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 162–63.

¹⁶⁰ See Freeman, *supra* note 151, at 552–53 (noting that “the large shareholder is not the source of stockholder proposals” but that the rule is used by “a very small group” of “small stockholders, either individuals or organizations, with an investment to which they are logically or emotionally committed for a long term”).

¹⁶¹ Ballots typically include all matters to be voted upon, including all candidates seeking a position on the board. The rules do not, however, permit proxy cards to include all choices. The absence of a universal proxy was the subject of a recommendation by the SEC’s Investor Advisory Committee. See U.S. SECS. & EXCH. COMM’N, RECOMMENDATIONS OF THE INVESTOR ADVISORY COMMITTEE REGARDING SEC RULEMAKING TO EXPLORE UNIVERSAL PROXY BALLOTS (2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf>. It has been added to the reform agenda of the Commission. See Mary Jo White, Chair of SEC, Remarks before the Society of Corporate Secretaries and Governance Professionals: Building Meaningful Communication and Engagement with Shareholders (June 25, 2015), <https://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html>.

¹⁶² The Commission does not, for example, ensure that companies clearly title shareholder proposals on the proxy card. See Lincoln Puffer, Note, *Proxy Cards and the Requirements of Clarity and Impartiality in Tilling Proposals*, 91 DENV. L. REV. ONLINE 167 (2014), http://static1.1.sqspcdn.com/static/f/276323/24757109/1397944325807/Puffer_D_ULROnline_Final-Format.pdf?token=apTz888HEPm2o%2BDXT6moDQf1Un4%3D.

management permitted to highlight proposals that it favors.¹⁶³

Most importantly, however, the rule allows for the involuntary transfer of voting rights for proposals known to management well in advance of the meeting.¹⁶⁴ Shareholders are left with a Hobson's choice of either conceding the transfer or preventing discretionary authority by giving up the right to vote.¹⁶⁵ Because discretionary authority is permitted but not mandated, shareholders could try to induce change through private ordering,¹⁶⁶ convincing companies to forego the authority,¹⁶⁷ or to provide a mechanism on the proxy card for the withholding of discretionary authority.¹⁶⁸ At least one company

¹⁶³ Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4185, 1948 WL 28695, at *1 (Nov. 5, 1948) (“The draft of Rule X-14A-4 which was circulated for public comment contained a provision that the form of proxy should contain no recommendation with respect to any matter to be acted upon. Upon further consideration of the matter, after reviewing the comments received, the Commission believes that this proposed change in the text of the existing rule would introduce ambiguities that would create administrative difficulties in construction and application of the rule. For that reason, this provision has been omitted from the amended rule.”).

¹⁶⁴ See *supra* note 28.

¹⁶⁵ See Coffee, *supra* note 91, at 620 (“[T]he public shareholder faces Hobson’s Choice: the shareholder can either grant a proxy to management (knowing that management will vote against this proposal) or refrain from voting.”). As discussed, shareholder could block and vote by attending the meeting. Nonetheless, for the most part, this is an impractical solution. See *supra* Section III.B.4.

¹⁶⁶ See SEC Staff Financial Bulletin No. 89, 49 Fed. Reg. 4936 (May 31, 1961), http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1960/1960_1964_Interprt_Corp_Finance.pdf (no action letter providing that there would be “no objection to a provision that a proxy would not be voted unless marked notwithstanding that Rule 14a-4(e) on its face requires that proxies be voted and disclosure made of how they would be voted”).

¹⁶⁷ See Rubbermaid Inc., SEC No-Action Letter, 1994 WL 4493, at *3 (Jan. 6, 1994) (“The proposal requests that unvoted proxies not be counted. The Division is unable to concur in your view that the proposal and supporting statement are false and misleading within the meaning of rule 14a-9. According, we are unable to concur in your view that the proposal may be omitted from the Company’s proxy materials in reliance on rule 14a-8(c)(3). The Division is also unable to concur in your view that the proposal is inconsistent with discretionary voting under rule 14a-4(c) or state law and therefore excludable under rule 14a-8(c)(1), (c)(2) or (c)(3). In the staff’s view, the cited provisions of federal and state law permit, rather than mandate, the discretionary voting of proxies by management.”).

¹⁶⁸ Some effort at private ordering has been made. See Rosemary Lally, *Carpenters’ Fund Continues to Make Progress on Auditor Disclosure*, COUNCIL OF INSTITUTIONAL INV’RS (July 16, 2015), http://www.cii.org/article_content.asp?edition=4§ion=13&article=603 (discussion efforts by the United Brotherhood of Carpenters Pension Fund to send letters to specified Fortune 500 firms in an effort to obtain information on auditor practices, including the tenure of the firm and whether the committee periodically considers whether there should be regular rotation of the auditor).

has implemented this approach.¹⁶⁹ As Chevron's proxy card provides: The proxy holders will vote in accordance with their discretion on such other matters as may properly come before the meeting and any adjournment or postponement thereof, including, without limitation, any proposal to adjourn the meeting to a later time and place for the purpose of soliciting additional proxies, unless the undersigned strikes out this sentence.¹⁷⁰

Private ordering could come about through the submission of shareholder proposals on the subject.¹⁷¹ Shareholders could also seek to engage in other types of self-help practices that are reminiscent of the "just say no" campaigns.¹⁷² Shareholders could, for example, collectively decide to not return their proxy cards to companies seeking discretionary authority deemed excessively broad. In doing so, the shares would not be present at the meeting and could not be used for discretionary voting. Their absence would also potentially impair efforts to obtain a quorum or the required percentage of votes needed for approval.

The approach, however, is not likely to be effective. The efforts would confront the logistical difficulties associated with obtaining a proxy card.¹⁷³ Shareholders opting not to return the card would, unless attending the meeting or circulating their own proxy statement, be

¹⁶⁹ See also *In re Union Electric Co.*, 23 P.U.R.3d 351, 1958 WL 96119, at *4 (Mar. 21, 1958) ("Rule X-14A-4 specifically permits the form of proxy to grant discretionary authority with respect to stockholder proposals omitted from a proxy statement pursuant to Rule X-14A-8, and the situation here comes within the scope of that Rule. It appears, as indicated above, that the stockholder may deny the authority in question by deletion or insertion in the form of proxy.").

¹⁷⁰ See Chevron Corp., Definitive Proxy Statement (Schedule 14A) (May 27, 2015) <https://www.sec.gov/Archives/edgar/data/93410/000119312515123775/d858886ddef14a.htm> (language appearing on the back of the proxy card in bold). For street name owners, this authority would also need to appear on the voting instruction form. See *supra* note 43.

¹⁷¹ Efforts to exclude proposals calling for an end to discretionary voting have not been successful. See *Centerior Energy Corp.*, SEC No-Action Letter, 1995 WL 18741, at *1 (Jan. 18, 1995) (exclusion not permitted of proposal providing "that future proxies shall have no discretionary voting power on matters where no voting directions have been given"). Of course, most proposals are precatory. As a result, they advise rather than require. See Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 151 ("Invariably phrased as a recommendation, the proposals advise rather than command."). To the extent receiving majority support, therefore, the proposals do not automatically change behavior but require agreement of management.

¹⁷² The approach was first suggested by Professor Grundfest. See Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 903-08 (1993).

¹⁷³ See *supra* Section IV.

forced to give up their voting rights. Large investors with fiduciary obligations would be unlikely to take these steps. As a result, support among the largest shareholders would remain low. In any event, private ordering would be a slow and difficult method of implementing reform.¹⁷⁴

Changes to the rule are, therefore, necessary.¹⁷⁵ The proxy rules require updating to reflect the current state of corporate governance, particularly the more cooperative and interactive relationship between owners and managers.¹⁷⁶ The goal would be a return to first principals and seek to ensure that the rules duplicated as much as possible the rights provided shareholders at the meeting. This would require two sets of changes to Rule 14a-4.

First, the rule should eliminate the right of companies to vote partially completed proxies. The Commission recognized, in the aborted reform efforts of 1979, that the evidence did not support the conclusion that a partially executed card reflects an intent by investors to allow management to vote the unmarked portions.¹⁷⁷ As currently configured, therefore, management has the ability to vote shares in a manner inconsistent with shareholder intent.

Second, the rule should be amended to address the problem of discretionary voting. One possibility would be to eliminate the practice entirely. In some circumstances, however, the ability of management to obtain voting discretion is arguably in the interests of investors. For matters genuinely unknown a reasonable time before the meeting, shareholders can benefit by having the matter resolved by persons obligated to act in their best interests.¹⁷⁸

¹⁷⁴ In proposing a rule to provide shareholder access to the company's proxy statement for their nominees, the Commission specifically rejected arguments that the matter should be left to private ordering, at least where the reform sought to facilitate the exercise of shareholder rights guaranteed under state law. *See* Facilitating Shareholder Director Nominations, Exchange Act Release No. 62764, 2010 WL 3343532 (Aug. 25, 2010) (“[W]e have reason to believe that reliance on private ordering under state law would be insufficient to meet our goal of facilitating the exercise of shareholders’ traditional state law rights to nominate and elect directors.”).

¹⁷⁵ The Commission has sometimes noted the need to amend the proxy rules to eliminate unnecessary restrictions on shareholder suffrage. *See* Facilitating Shareholder Dir. Nominations, Securities Exchange Act Release No. 60089, 2009 WL 1953653, at *5 (June 10, 2009) (“[W]e believe that parts of the federal proxy process may unintentionally frustrate voting rights arising under state law, and thereby fail to provide fair corporate suffrage.”).

¹⁷⁶ *See* Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 179–80.

¹⁷⁷ *See supra* note 53.

¹⁷⁸ The authority to vote rests with the person appointed as the proxy. The presence of fiduciary obligations depends upon the identity of the proxy. To the extent an officer or director, the proxy will have the requisite duties. *See supra* note

Other than unexpected matters, however, the argument for discretionary authority—at least discretionary authority transferred on an involuntary basis—is much weaker. To the extent management has adequate notice of a proposal to be made at the meeting, shareholders should have a say in the outcome. This is true for any matter submitted in a timely fashion, whether omitted under Rule 14a-8 or submitted as a “Non-Rule 14a-8 Proposal.”¹⁷⁹ In those circumstances, the proxy statement should disclose the matters and the proxy card (and by extension the voting instruction form) should provide a mechanism for shareholders to vote for or against the proposal. Alternatively, the card could provide a mechanism to withhold discretionary voting.¹⁸⁰

VII. CONCLUSION

The evolution of the proxy rules during their first half-century of existence did not always reflect the legitimate interests of shareholders. The rules sometimes reduced the rights that existed under state law.¹⁸¹ In particular, this occurred in connection with voting rights. Under Rule 14a-4, shareholders were subjected to an involuntary transfer of voting rights to management to resolve any proposal that did not appear in the proxy statement but arose from the floor of the meeting.¹⁸² The only practical way to prevent the transfer was to forsake voting rights at the meeting.¹⁸³

The evolution of the proxy rules has, however, become more balanced.¹⁸⁴ Yet the vestiges of earlier eras remain in place. As the

41.

¹⁷⁹ See *supra* Sections III.B.2, III.B.3.

¹⁸⁰ Two mechanisms have been suggested. Chevron provided an opportunity to simply cross out the language authorizing discretionary authority. See *supra* note 170. The Commission, on the other hand, proposed that proxy cards include “a box to withhold discretionary authority.” Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39093, 1997 WL 578696, at *41 (Sept. 18, 1997).

¹⁸¹ *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 954 A.2d 335, 342 (Del. Ch. 2008) (“Rule 14a-8 is a compromise that allows for the presentation of some shareholder proposals without the cost of soliciting proxies, but what a shareholder may do under Rule 14a-8 is far different than what a shareholder may do on his or her own.”), *aff’d*, 947 A.2d 1120 (Del. 2008).

¹⁸² See *supra* Section III.

¹⁸³ See *supra* Section IV.

¹⁸⁴ See Brown, *The Evolving Role of Rule 14a-8*, *supra* note 10, at 152 (“Once the Rule was rewritten into plain English in 1998, evolution became more balanced. Indeed, in 2010, the Commission amended Rule 14a-8 in order to narrow one of the exclusions.”). In 2010, the Commission amended Rule 14a-8 to narrow the scope of exemption (i) (8). See Nicole L. Jones, Note, *Shareholder Proposals, Director Elections, and Proxy Access: The History of the SEC’s Impediments to Shareholder Franchise*, DENV. L. REV. ONLINE (May 6, 2016), <http://www.denverlawreview.org/dlr-onlinearticle/2016/5/6/shareholder-proposals-director-elections-and-proxy-access->

2016]

THE PROXY RULES

83

Securities Exchange Act of 1934 approaches its 82nd anniversary, care needs to be taken so that the relevant rules and regulations retain their vitality and effectiveness, reflecting not just the corporate governance structure in place during the Great Depression, but also those that exist today. In the proxy area, this means returning to a simpler, more neutral, approach that better reflects the interests of all of the participants in the corporate governance debate.