08-5842-cv

IN THE

United States Court of Appeals for the Second Circuit

LUCIAN BEBCHUK,

Plaintiff-Appellant,

v.

ELECTRONIC ARTS INC.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* SUPPORTING APPELLEE AND AFFIRMANCE

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RULE 26.1 DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amicus curiae*, the Chamber of Commerce of the United States of America (the "Chamber"), hereby certifies that it has no parent corporation, and that no public company owns 10 percent or more of the Chamber's stock.

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The Chamber of Commerce of the United States of America (the "Chamber") respectfully submits this brief as *amicus curiae* in support of Electronic Arts Inc. ("EA") and affirmance.

All parties have consented to the Chamber's filing of this brief. *See* Fed. R. App. P. 29(a).

STATEMENT OF INTEREST

The Chamber is the world's largest business federation. The Chamber represents an underlying membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. A principal function of the Chamber is to convey the unique perspective of the business community by filing *amicus curiae* briefs in cases involving issues of national concern to American businesses, including cases under the federal securities laws.[1]

This case presents the question whether the Securities Exchange Act of 1934 and its implementing regulations require a company to include in its own proxy materials a shareholder proposal that, if approved, would deprive the company of the ability it currently has under the law to exclude from its proxy materials shareholder proposals that fail to satisfy certain clearly-delineated criteria. That question is of significant concern to the Chamber, whose members include issuers of securities registered with the Securities and Exchange Commission ("SEC") and listed on national securities exchanges that on occasion receive shareholder proposals and exclude them from the corporate proxy materials. The proponents of

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[1] *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005).

those proposals often use the shareholder proposal mechanism to promote their own narrow, parochial interests or to demand that the issuer address political or social issues disconnected from the issuer's business. Indeed, as the Investment Company Institute recently concluded, such proposals "tend to be sponsored by a small number of individuals and organizations."[2]

The legitimate exclusion of certain proposals protects shareholders. It also makes each company's proxy materials easier to comprehend and less expensive for the company (and thus its shareholders) to prepare and distribute, and facilitates shareholders' review and evaluation of those materials before voting. The Chamber therefore has both a unique perspective on the impact the decision in this case will have, and a keen interest in ensuring that the legal framework under which its members operate is rational, fair, and consistent. Accordingly, and with the consent of all parties, the Chamber submits this brief in support of EA and affirmance.

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[2] *Proxy Voting By Registered Investment Companies: Promoting the Interests of Fund Shareholders*, Investment Company Institute Research Perspective, Vol. 14, No. 1 (July 2008), at 1 [hereinafter *Proxy Voting*]. "One-third of the more than 600 shareholder proposals that came to a vote in the year ending June 30, 2007, were sponsored by five individuals and three labor unions." *Id.*

SUMMARY OF ARGUMENT

This case presents a straightforward and narrow question of *federal* law—namely, whether Rule 14a-8 compels EA to include Plaintiff's proposal in the company proxy even though the proposal conflicts with Rule 14a-8 itself and the SEC's other proxy rules. The answer is no. Moreover, the judgment of dismissal embodies a correct understanding of the relationship between state and federal law in the proxy communication domain.

I. State law allocates authority among shareholders and the board and management. As a general principle, when a shareholder seeks to propose that a particular action be considered at a shareholder meeting, the shareholder must prepare its own proxy materials advocating that action.

The SEC's Rule 14a-8 provides a precisely-defined exception to the general principle. The Rule requires a public company to include in its proxy materials certain shareholder proposals satisfying defined prerequisites, but the Rule also provides several grounds on which a company may, consistent with SEC guidance, exclude particular proposals. The exclusions reflect a careful balancing of competing interests by the SEC.

II. The complaint asserts that Rule 14a-8 mandates inclusion of Plaintiff's proposal in EA's proxy materials. Plaintiff's unfounded contention is that Rule 14a-8 requires a company to include in its proxy materials a proposal that, if

enacted, thereafter would circumvent the Rule, forcing companies to include in their proxy materials shareholder proposals that fail to satisfy the requirements that Rule 14a-8 and the other SEC rules have established to protect investors. Plaintiff thus seeks to use the Rule to install an alternative procedure, less protective of shareholders, that would render irrelevant the very agency regulation on which he bases his claim to relief.

Plaintiff's fundamental aim is the substitution of his opinion for the SEC's judgment about what types of shareholder proposals warrant inclusion in company materials. Were his argument correct, shareholders at every public company could use Rule 14a-8 to establish their own process for placing shareholder proposals in company proxy materials—thereby negating the investor protections of the SEC's proxy rules. Rule 14a-8 cannot be interpreted to require its own undoing.

III. The decision below does not conflict with state law. Indeed, it is Plaintiff, not the District Court, that has profoundly misapprehended state law.

Rule 14a-8 makes clear that, at least in the absence of a provision enforceable under state law that requires otherwise, a public company's board and management have the discretion not to include in the corporate proxy materials proposals that fall within the Rule's exclusions. Here, Plaintiff cannot plausibly claim the benefit of any such provision enforceable under state law—a bylaw, certificate provision, or statute—that would override that discretion. Furthermore, Plaintiff's

evident aim is to use Rule 14a-8, which is a carefully-circumscribed exception to the general principle concerning shareholders' obligation to prepare and distribute their own proxy materials, to establish shareholder utilization of company proxy materials as the new general principle. That would impermissibly disrupt state law teachings.

ARGUMENT

I.

Rule 14a-8 Provides A Precisely-Defined Exception To The General Rule That Shareholders Must Prepare And Distribute Their Own Proxy Materials, Rather Than Utilize The Company's Materials.

1. State law governs the internal affairs of the corporation, and prescribes the corporate acts that require shareholder authorization. "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977) (internal quotation marks and emphasis omitted).[3]

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[3] That is, "state law defines the rights of shareholders, including the extent to which shareholders can propose by-law amendments and nominate directors, and

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EA is incorporated in Delaware. Title 8 of the Delaware Code, the Delaware General Corporation Law ("DGCL"), governs the corporation's decision to hold annual meetings, or to convene special meetings other than the annual meeting, at which shareholders vote to elect directors and approve other major corporate decisions. DGCL § 211. Shareholders typically do not attend annual or special meetings to vote in person; instead, as Delaware law allows, they vote on corporate actions raised at such meetings "by proxy"—such as by giving written authorization to others to act on their behalf. *Id.* §§ 212(b), (c).

Although state law determines the allocation of governance power among shareholders and directors, and establishes the shareholder right to vote by proxy, with respect to companies (such as EA) that issue publicly-traded securities registered with the SEC, Congress gave the SEC the "power to control the conditions under which proxies may be solicited." *Bus. Roundtable v. SEC*, 905 F.2d 406, 410 (D.C. Cir. 1990) (quoting H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934)).

In particular, Section 14(a) of the Exchange Act (15 U.S.C. § 78n(a)) makes it unlawful to "solicit . . . any proxy" "in contravention of such rules and regula-

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the extent to which they have access to the company's proxy to do so." Letter from David T. Hirschmann, Senior Vice President, Chamber of Commerce of the United States of America, to Nancy M. Morris, Secretary, SEC, re: Proposed Rules Relating To Shareholder Access, at 11 (Oct. 2, 2007).

tions as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." Invoking that authority, the SEC has promulgated regulations covering "not only the information required to be disclosed to ensure that shareholders receive full disclosure of all information that is material to the exercise of their voting rights under state law and the corporation's charter, but also the procedure for soliciting proxies." Shareholder Proposals Relating to the Election of Directors (Proposed Rule), Rel. No. 34-56161, 72 Fed. Reg. 43,488, 43,489 (July 27, 2007).

Multiple sets of proxy materials may exist in connection with a single shareholder meeting. One set of materials, controlled by the company, addresses matters the company considers necessary to present to shareholders, based on the fiduciary obligations of the board and management to act in the best interests of the company and the shareholders. It is a "well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action," *i.e.*, when the company solicits proxies. *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

Other sets of materials are controlled by shareholder proponents. The general principle is that a shareholder who desires to have a matter considered at a shareholder meeting must do so by preparing and distributing its own proxy mate-

rials. Delaware courts thus frequently confront cases arising from so-called proxy contests, in which the company and the shareholder proponents issue competing proxy solicitations.[4]

With respect to public companies, *all* proxy solicitation materials—those of the company, and those of any shareholder proponent—must contain the disclosures required by the SEC. The SEC regulations include a panoply of protections designed to ensure that all proxy materials received by shareholders meet certain minimum standards designed to protect investors. One such regulation, Rule 14a-3 (17 C.F.R. § 240.14a-3), requires any party that solicits proxies to file with the SEC and provide to solicited shareholders a proxy statement that contains the information specified in Schedule 14A (17 C.F.R. § 240.14a-101). That schedule includes information about any financial or other interests that the shareholder has in the proposal. It also includes information regarding the identity and interests of persons other than the shareholder who may be funding the shareholder's proposal. *See* Schedule 14A, Item 4. Another regulation of overarching importance to investor protection is Rule 14a-9 (17 C.F.R. § 240.14a-9), which "prohibits the solicita-

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[4] *See, e.g.*, *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 788-803 (Del. Ch. 2007) (describing "tumultuous struggle" involving multiple proxy solicitations); *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1118-20, 1122-23 (Del. Ch. 1990) (rejecting shareholder's claim that board improperly postponed annual meeting in response to his threat to commence proxy contest).

tion of proxies by means of materially false or misleading statements" (*Va. Bankshares, Inc., v. Sandberg*, 501 U.S. 1083, 1087 (1991)).

2. A precisely-circumscribed *exception* to the general principle described above—that shareholders must prepare their own proxy materials to raise a matter at a shareholder meeting—is set forth in Rule 14a-8 (17 C.F.R. § 240.14a-8), the Rule at issue here. Established with its current structure in the 1940s and amended on several occasions since, Rule 14a-8 provides a channel through which a shareholder owning a specified stake in the company may submit a proposal for inclusion in the company's proxy statement—at the company's expense, and therefore at the expense of every other shareholder—so long as distinct eligibility and procedural requirements are met and an exclusion does not apply. "In all cases, the proposal may be excluded by the company if it fails to satisfy the [R]ule's procedural requirements or falls within one of the [R]ule's thirteen substantive categories of proposals that may be excluded." Rel. No. 34-56161, 72 Fed. Reg. at 43,490.[5]

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[5] As the description of parts of Rule 14a-8 as "procedural" and others as "substantive" suggests, Rule 14a-8 can be said to "lie in a murky area between substance and procedure." *Cf. Bus. Roundtable v. SEC*, 905 F.2d 406, 411 (D.C. Cir. 1990) (noting that Rule 14a-4(b)(2), as then codified, may be so characterized). Yet the Exchange Act arguably empowers the SEC only to provide procedural rules for proxy solicitations, leaving substantive matters to state law. *See, e.g.*, *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964) ("The purpose of § 14(a) is to prevent

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In defining each of these 13 categories over the decades, the SEC has sought not to upset the balance under state law between the interests of the board and management (who owe shareholders a fiduciary duty to act in the company's best interests) and the interests of shareholder proponents (who owe no such duty). Rule 14a-8 therefore has been characterized as providing shareholder proponents with a precisely-circumscribed right that is "informational" (*Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 421 (D.C. Cir. 1992)), with the exclusions set forth in Rule 14a-8 marking the outer boundaries of that right. Although a shareholder may prefer to use the Rule 14a-8 channel because it is more "inexpensive" and "economically realistic" than preparing and distributing independent proxy materials (*cf.* Appellant's Br. 6), a shareholder cannot use that channel unless the proposal conforms to Rule 14a-8. For all other proposals the shareholder retains the familiar and long-standing right under state law to "notif[y] the company in advance of the [annual shareholder] meeting of his or her intention to present the proposal from the floor of the meeting," and to "commence[] his or her own proxy solicitation, without ever invoking [R]ule 14a-8's procedures."

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management or others from obtaining authorization for corporate action *by means of deceptive or inadequate disclosure* in proxy solicitation.") (emphasis added). Because the issue is not presented here, this Court may assume without deciding that Rule 14a-8 is a proper exercise of the SEC's authority under Section 14(a) of the Exchange Act.

Amendments To Rules On Shareholder Proposals, 63 Fed. Reg. 29,106, 29,109 (May 28, 1998) (Final Rule).

The Rule entrusts the company's board and management rather than shareholders with the task of determining whether grounds for exclusion exist, and provides a significant role for the SEC also: A company must notify the SEC and the proponent of its intent to exclude a proposal, and the basis for doing so. *See* Rule 14a-8(j) (17 C.F.R. § 240.14a-8(j)). This "no-action letter" procedure enables the SEC to supply informal guidance to companies and shareholders about which proposals must be included in the company's proxy materials. Companies for their part have been careful in exercising their ability to exclude proposals; "[o]nly about 14 percent of shareholder proposals [received have been] omitted" in recent years. *Proxy Voting*, *supra* note 2, at 5 & n.7.

II.

Rule 14a-8 Cannot Be Construed To Mandate Inclusion In Company Proxy Materials Of Shareholder Proposals That Would Circumvent And Nullify The Investor Protections Set Forth In Rule 14a-8 And Other SEC Regulations.

Plaintiff's proposal is irreconcilable with the existing federal regime governing proxy solicitation. The proposal seeks to establish a process under which so-called Qualified Proposals would be included in the company proxy statement virtually automatically, even where inclusion would be inconsistent with the terms of

Rule 14a-8 and the SEC's other proxy rules, all of which constitute long-standing agency interpretations of Section 14(a) of the Exchange Act. In general, Plaintiff's proposal rests on the assumption that shareholders can use the SEC rules to cause a company to carve itself out of those rules. That assumption is incorrect. Proxy rules such as Rule 14a-3, which requires persons who solicit proxies to disclose extensive information, and Rule 14a-9, which bans false and misleading statements, are binding legal requirements, not mere "best practices" that companies and shareholders may disregard.

Rule 14a-8 is thus a carefully-defined exception to the principle that shareholders seeking to put forth proposals should do so through their own proxy materials that comply with the proxy rules. That exception cannot be construed to swallow itself and the other proxy rules wholesale. Under Rule 14a-8(i)(3)'s provision allowing exclusion of proposals that conflict with the proxy rules, EA therefore was permitted to omit Plaintiff's proposal from the company proxy materials.

1. It is notable as an initial matter that this case is before the Court upon an inferred right of action under an SEC rule. Section 14(a) of the Exchange Act does not create any private rights by its terms. Although the Supreme Court has continued to recognize a private right of action for materially misleading statements in proxy materials in violation of Rule 14a-9 (*Sandberg*, 501 U.S. at 1104-05), the Court's recent pronouncements give reason to question whether the SEC's

shareholder proposal procedures set forth in Rule 14a-8—which are entirely a creature of agency rulemaking—give rise to a private right of action in any circumstance. *See Alexander v. Sandoval*, 532 U.S. 275, 291 (2001) ("Language in a regulation may invoke a private right of action that Congress through statutory text created, but it may not create a right that Congress has not . . . . Agencies may play the sorcerer's apprentice but not the sorcerer himself."). The Supreme Court has applied this same principle to other SEC regulations interpreting the Exchange Act. *See Cent. Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 173 (1994) ("the private plaintiff may not bring a [SEC Rule] 10b-5 suit against a defendant for acts not prohibited by the text of [Exchange Act] § 10(b)"); *cf. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 772 (2008) ("In the absence of congressional intent the Judiciary's recognition of an implied private right of action necessarily extends its authority to embrace a dispute Congress has not assigned it to resolve.") (internal quotation marks omitted).[6]

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[6] This Court may affirm by assuming, without deciding, that an implied private right of action exists under Section 14(a) for violations of Rule 14a-8(i), because even if such a right of action were to exist, Plaintiff's claim would fail. Neither the Supreme Court nor this Court has decided the implied right question. In recognizing an implied right of action for violations of Rule 14a-4(a)(3) and 14a-4(b)(1) (17 C.F.R. §§ 240.14a-4(a)(3), 240.14a-4(b)(1)), which forbid grouping several matters into one vote in a solicitation, the court in *Koppel v. 4987 Corp.*, 167 F.3d 125 (2d Cir. 1999), relied on the reasoning of a District of Columbia Circuit case that discerned an implied right for violations of Rule 14a-8(i). That, however, is

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Whatever the merits of a shareholder inferring a right of action from Rule 14a-8 in other contexts, inferring a right to the remedy sought in *this* case is plainly inappropriate. Paradoxically, the shareholder is attempting to use Rule 14a-8 to install a new shareholder proposal process that has no basis in the statute and that, once in place, would nullify the very regulation that Plaintiff asks this Court to "enforce." Rule 14a-8 cannot, on the one hand, be so important an application of Section 14(a) of the Exchange Act as to warrant a shareholder right of action to vindicate its purposes in federal court and, on the other hand, be so slim and insubstantial an articulation of the federal interest in the proxy process that shareholders may convert it to an escape hatch to avoid, in the future, Rule 14a-8 and the other SEC rules governing proxy solicitation.

2. The complaint erroneously characterizes Plaintiff's proposal as one that would merely "establish internal rules and guidelines . . . that regulate the extent to which and the ways in which the company would exercise the discretion

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not a holding by this Court on point. *See id.* at 134-38 (citing *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416 (D.C. Cir. 1992)). *Koppel* was decided before the Supreme Court's significant, recent articulation of the standard for inferring rights of action for violations of agency regulations in *Alexander v. Sandoval*, 532 U.S. 275 (2001). In *AFSCME v. AIG, Inc.*, 462 F.3d 121, 131 (2d Cir. 2006), this Court reached the merits of a claim that a shareholder proposal was improperly excluded from the company proxy without addressing the antecedent question whether Congress had authorized the shareholder's suit. That decision obviously cannot be viewed as a holding on the point.

provided in Rule 14a-8 to determine which proposals to include in its proxy materials." Compl. ¶ 29. That characterization belies the radical import of Plaintiff's proposal, which would enable shareholders to place proposals for bylaw amendments in the company proxy materials without being screened for the various characteristics that the SEC has deemed warrant exclusion under Rule 14a-8. Plaintiff's proposal also would remove the role of the board and management in determining whether to exclude a proposal from the company's proxy materials, and the role of the SEC in overseeing that process.

The SEC's rule establishes 13 separate grounds for excluding shareholder proposals from the company proxy. Plaintiff's proposal would sweep away *most* of these, including exclusions for proposals that: concern a personal claim or grievance, insignificant matters, or elections to corporate office; conflict with a board proposal; have been rendered moot; are duplicative of similar proposals in the current year; essentially repeat a proposal from prior years; or address specific dividend amounts. Conversely, Plaintiff apparently has decided that several of the exclusions the SEC provided for in Rule 14a-8(i) warrant incorporation in his proposal, albeit in somewhat different form. Thus, Plaintiff's proposal (Compl. ¶ 18) requires in Paragraph (b) that each proposed bylaw amendment be "valid under applicable law." *Cf.* Rule 14a-8(i)(2) (proposal would cause violation of law), (i)(3) (proposal misleads or otherwise contravenes proxy rules), (i)(6) (company

lacks power to implement). Paragraph (c) of Plaintiff's proposal requires that each proposed bylaw amendment be "a proper action for stockholders under state law" (*cf.* Rule 14a-8(i)(1) (similar)), and that it not "deal with a matter relating to the Corporation's ordinary business operations" (*cf.* Rule 14a-8(i)(7) (similar)). *See also* Appellee's Br. 23.

The SEC, however, has assessed the costs and benefits of each of the 13 exclusions, and has concluded that all 13 exclusions are "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78n(a). Thus, for example, the exclusion regarding dividends enables the company to deal with simultaneous "issuer proposals asking that differing amounts of dividends be paid" (Adoption of Amendments Relating to Proposals by Security Holders, Rel. No. 34-12999, 41 Fed. Reg. 52,994, 52,999 (Nov. 22, 1976)), and the exclusion for personal claims or grievances exists "because . . . an issuer's proxy materials" are not a legitimate "forum for airing personal claims or grievances" (*id.* at 52,997).

The harm inflicted by proposals designed to further personal claims and undisclosed interests is not merely theoretical but real in the current era of activism by, among others, hedge funds and certain institutional investors. Hedge funds often have shorter investment horizons than long-term investors, and they sometimes structure their securities holdings so as to earn higher returns when a company's share price decreases, which leads their interests to diverge from those of other

shareholders. *See, e.g.*, SEC, *Implications of the Growth of Hedge Funds* 42 (Sept. 2003) (discussing hedge funds' short-selling strategies). Among institutional investors, "[t]hose . . . most inclined to be activist investors are associated with state governments and labor unions, and often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest." Vice Chancellor Leo E. Strine, Jr., *Toward A True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 Harv. L. Rev. 1759, 1765 (2006). Allowing such shareholders to use corporate assets to campaign for bylaw amendments, without requiring them to provide the full disclosures required when they solicit using their own proxy material, disserves investors at large.

Thus, a shareholder such as Plaintiff who seeks to use Rule 14a-8 to establish an alternative channel for shareholder use of the company proxy materials is not entitled to a court order licensing him to pick and choose among the SEC exclusions, as though they were part of an à la carte menu rather than a regulation with the force of law. Professor Bebchuk may have lively policy disagreements with the SEC about the optimal structure of Rule 14a-8 and the desirability of

some of the exclusions it contains.[7] Such disagreements are properly resolved by the elected branches and their subordinate agencies, not the courts: "The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones." *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 866 (1984). When a court examines a "comprehensive regulatory program"—such as the proxy rules at issue here—the case against "judicial innovation" is particularly strong. *Black & Decker Disability Plan v. Nord*, 538 U.S. 822, 831-32 (2003).

3. The logical consequence of Plaintiff's claim in this case is that shareholders at every public company may use Rule 14a-8 to establish their own separate and unique system for availing themselves of the company's proxy materials—in lieu of the general principle that they must file their own proxy materials (at their own expense) and satisfy applicable disclosure requirements, including those in the SEC rules. Nothing in the complaint suggests that the particular set of Rule 14a-8 exclusions Plaintiff's proposal omits is the *only* permissible set of disposable exclusions under his theory. The unitary Rule 14a-8 process that the SEC

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[7] Plaintiff has opined that "[i]t would be desirable to dismantle existing impediments to shareholders' ability to replace directors and to shape companies' corporate governance arrangements." *Empowering Shareholders On Executive Compensation*, Hearing Before the H. Comm. on Financial Services, 110th Cong. 73 (2007).

authoritatively administers for the benefit of all issuers would therefore dissolve into a company-by-company customization of procedures for placing shareholder proposals in company proxy materials.

The SEC previously considered and rejected just such a customization approach. In 1982, it considered permitting company-specific alternative procedures. *See* Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Rel. No. 34-19135, 47 Fed. Reg. 47,420 (Oct. 14, 1982). In 1983, it declined to adopt such a regime. *See* Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Rel. No. 34-20091, 48 Fed. Reg. 38,218 (Aug. 23, 1983). The SEC acknowledged what many rulemaking comments explained: Customization would "create serious problems of administration as there would be no uniformity or consistency in determining the inclusion of security holder proposals. Exacerbating the problem generated by provisions individual to each issuer would be the effect of the fifty state judicial systems administering the process." *Id.* at 38,218.

Notwithstanding the SEC's policy judgment on the point, Plaintiff here seeks a judicial order under Rule 14a-8—a precisely-defined exception to the proxy solicitation principle—to wrest control of proxy regulation from the federal agency responsible for interpreting and enforcing the federal securities law regime.

But there obviously is no warrant for "enforcing" Rule 14a-8 so as to effectively nullify itself and the judgments it embodies, and to serve as the vehicle for radically altering the proxy solicitation landscape.

Courts do not "imput[e] to Congress a purpose to paralyze with one hand what it sought to promote with the other" (*Am. Paper Inst., Inc. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 421 (1983) (internal quotation marks omitted)), and courts likewise do not interpret agency regulations as requiring their own paralysis. In this case, construing Rule 14a-8 to require inclusion in the company proxy materials of a proposal that would nullify that very Rule would work just such a result. As the District Court appropriately determined in dismissing the complaint, Rule 14a-8 and the other SEC proxy rules cannot support Plaintiff's interpretation.

III.

Nothing In State Law Requires Defendant To Surrender Responsibility Over Company Proxy Materials To Shareholder Proponents.

As shown above, this narrow and straightforward case hinges on the meaning of federal law, *i.e.*, Rule 14a-8 and the SEC's other rules for proxy solicitation. Plaintiff strives instead to transmute it into one hinging on *state* law, asserting that the District Court "completely ignored" applicable Delaware authority. Appellant's Br. 16.

Plaintiff's effort to appoint himself guardian of the line between federal and state law is ironic. Rule 14a-8 is a precisely-defined federal law exception to the general state law principle requiring shareholders to present their proposals in their own proxy materials; Plaintiff would exploit that exception to install a new general principle licensing shareholders to present their proposals through the company's proxy materials. He seeks to drive Rule 14a-8 through the very state law boundary he accuses the District Court of having "completely ignored."

That fundamental inconsistency is fatal to Plaintiff's argument. To use the carefully-circumscribed exception of Rule 14a-8 to make placement of shareholder proposals in company proxy materials the everyday norm would disrespect state law governing proxy communication no less than it disrespects federal law.

Nor is Plaintiff's argument any more persuasive when examined in finer detail. His theory appears to be that (1) Delaware law controls this case, and that (2) he is entitled to relief under Rule 14a-8 because (a) his proposal is valid under Delaware law, and (b) Rule 14a-8 leaves open the possibility that shareholders may, under Delaware law, shift control of company proxy materials from the board and management to shareholders, thus requiring that proposals such as his be included in company proxy materials. Appellant's Br. 22-31. Each component of that theory is incorrect.

1. Plaintiff errs in contending that the asserted legitimacy of his proposal under Delaware law is of "controlling importance" to his claim. Appellant's Br. 30. Rather, state law is a tangential deviation away from the determinative question of federal law in this case. For *even if* state law authorized shareholders to prohibit the board of directors and management from excluding shareholder proposals under Rule 14a-8, a shareholder proposal to establish such a prohibition through Rule 14a-8 would conflict with the Rule as well as the SEC's other rules governing proxy solicitation. Thus, the purported consistency between Plaintiff's proposal and *state* law does nothing to save his proposal from being "contrary to the proxy rules" under federal law and thus excludable under Rule 14a-8(i)(3) for the reasons given in Point II, above.

2. Plaintiff also is mistaken in asserting that (a) Delaware law clearly validates his proposal, and (b) Rule 14a-8 itself makes such validity dispositive of Plaintiff's claim.

a. Section 141 of the DGCL gives boards of directors broad authority over corporate affairs, providing: "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DGCL § 141(a). By its terms this statute makes no exception

for Section 109 (DGCL § 109(b)), which authorizes shareholders to approve bylaw amendments.

Although the Delaware Supreme Court has yet to "articulate with doctrinal exactitude a bright line that divides those bylaws that shareholders may unilaterally adopt under Section 109(b) from those which they may not under Section 141(a)" (*CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 234 (Del. 2008)), it has recognized a "prohibition, . . . derived from Section 141(a), against contractual arrangements that commit the board of directors to a course of action that would preclude them from *fully discharging* their fiduciary duties to the corporation and its shareholders" (*id.* at 238 (emphasis added)). On that basis, the court in *CA* invalidated a proposed bylaw which would have "committ[ed] the corporation to reimburse the election expenses of shareholders whose candidates are successfully elected." *Id.* at 237.

Plaintiff's proposal would likewise be invalid under that prohibition. Directors are under a "fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action" (*Stroud*, 606 A.2d at 84), and shareholder control of company proxy materials would impermissibly interfere with the directors' ability to carry out that indefeasible duty. Plaintiff fails to identify a single Delaware case that holds, or even suggests, that bylaw amend-

ments which place a broad restriction on directors' and managers' control of the company proxy are valid *per se*. Appellant's Br. 28; Professors' *Amicus* Br. 14.

Although Plaintiff's proposal, if adopted, would require directors to include in company proxy materials Qualified Proposals "to the extent permitted by law" (Appellant's Br. 10), that does not suffice to give directors the flexibility necessary to faithfully execute the fiduciary duty. Because the Delaware courts do not rule on the validity of proposed bylaws before enactment absent certification of a legal question from the SEC (*see* Del. Sup. Ct. R. 41), directors will not know whether they are authorized to exclude a questionable Qualified Proposal, and they may feel compelled to include it. Delaware law does not tolerate such an encroachment upon the board's fiduciary duty. Plaintiff's "permitted by law" clause fails to "reserve to [EA]'s directors their *full power* to exercise their fiduciary duty to decide whether or not it would be appropriate, in a specific case, to" exclude a Qualified Proposal. *CA*, 953 A.2d at 240 (emphasis added).

In short, this Court should decline Plaintiff's invitation to adopt a strained reading of federal law that only creates problems under Delaware law as well.

Evidencing the continuing evolution in this area, and further counseling against federal court intervention, is Delaware's adoption in April 2009 of Section 112 of the DGCL, on "[a]ccess to proxy solicitation materials." Effective August 1, 2009, the provision permits the adoption of corporate bylaws under which "if the

corporation solicits proxies with respect to an election of directors, it may be required, to the extent and subject to such procedures or conditions as may be provided in the bylaws, to include in its proxy solicitation materials" not only nominations by the board of directors, but also shareholder nominations of "one or more individuals." Section 112 will thus authorize shareholders to adopt bylaw amendments enabling them under certain circumstances to place nominations for director into the corporate proxy materials. Such bylaw amendments may not be proposed using the Rule 14a-8 mechanism, however. *See* 17 C.F.R. § 240.14a-8(i)(8) (permitting exclusion from company proxy materials of shareholder proposals relating to elections or election procedures).

This recent reform substantially promotes an objective of Plaintiff's—wider adoption of requirements that companies "include the names of director candidates proposed by shareholders in proxy materials" (Professors' *Amicus* Br. 8)—thereby undercutting Plaintiff's policy arguments for stretching Rule 14a-8 to achieve that objective. At the same time, Section 112 gives no endorsement to a proposal such as Plaintiff's—which sweeps far more broadly than would a Section 112 bylaw amendment, by demanding inclusion of all kinds of shareholder proposals, not simply nominations for director, in company proxy materials. (Section 112 also fails to support Plaintiff's claim for the reasons EA identifies. Appellee's Br. 43-45.)

b. Plaintiff next appears to contend that Rule 14a-8's text is open to the possibility that the "company" proxy materials actually belong to shareholders collectively, and therefore any shareholder proposal to shift authority over "company" proxy materials to shareholders in a manner consistent with Delaware law is immune from exclusion from company proxy materials under Rule 14a-8. *See* Appellant's Br. 23-26.

This strained reading of Rule 14a-8 focuses on one provision of the Rule in which the term "company" is used separate from the term "board of directors"—namely, Rule 14a-8(a)'s definition of a shareholder proposal as a "recommendation or requirement that the company and/or its board of directors take action." On this slim reed, Plaintiff builds his argument that under Rule 14a-8 the "company" and "board" are distinct and therefore that the "company" proxy may be controlled by shareholders, not the company's board and management.

Plaintiff's mistake is to focus myopically on a snippet while overlooking the regulation as a whole. It is a "fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used." *Deal v. United States*, 508 U.S. 129, 132 (1993). That is, because regulatory interpretation, like statutory interpretation, is "a holistic endeavor" (*Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 60 (2004) (internal quotation marks omitted)), the language

of Rule 14a-8, including the phrases "company" and "board of directors," must be read with a view to its place in the overall regulatory scheme.

Viewed in light of those principles, Rule 14a-8 clearly presupposes directorial and managerial superintendence over the company proxy materials, at least where state law does not provide otherwise. Rule 14a-8 repeatedly refers to a distinction between the "company" on one hand and the "shareholder[s]" on the other hand. *See* 17 C.F.R. 240.14a-8; *see also* Appellee's Br. 35 & n.68. The very definition of the term "shareholder proposal" on which Plaintiff concentrates draws that distinction. Those references refute the assertion that "company" proxy materials are or may be presumptively controlled by shareholders.

Even if those references were to make it ambiguous whether the "company" means "shareholders" instead of "the board and management," any such ambiguity properly would be resolved against Plaintiff's position, "because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *Koons*, 543 U.S. at 60 (internal quotation marks omitted). In light of all of the SEC's proxy regulations, it would indeed be nonsensical to read Rule

14a-8 as though each reference to the "company" referred to the shareholders individually or collectively.[8]

Thus, "company" necessarily means the corporation whose issuance of securities traded on a national exchange brings it within the registration requirement of the federal securities laws and, therefore, Rule 14a-8. Under state law, such a corporation properly acts through management, as overseen by the board. And Rule 14a-8 does not purport to allocate power between shareholders on one hand and the board and management on the other. As one Delaware court succinctly explained, "although Rule 14a-8 does open the doors to management's proxy materials, management retains significant power as a gatekeeper." *JANA Master Fund, Ltd. v.*

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[8] Two examples suffice. First, Rule 14a-4 places proxy forms into two categories—(i) those "on behalf of" a "majority of" the "registrant's board of directors," and (ii) those on behalf of another person—and requires forms in both categories to clearly identify the person "on whose behalf the solicitation is made." 17 C.F.R. § 240.14a-4(a)(1). That bifurcation makes sense because in practice most proxy forms belong to the first category. The "company" proxy form is understood to mean the proxy form of the board majority, not a shareholder proponent or even the shareholders at large.

Second, under Rule 14a-8(f)(1), if the shareholder proponent fails to satisfy a procedural requirement, "[t]he company may exclude your proposal, but only after it has notified you of the problem, and you have failed adequately to correct it." 17 C.F.R. § 240.14a-8(f)(1). It would be absurd to view this provision as conscripting shareholders to evaluate and respond to proposals from other shareholders. Yet that would be the natural consequence of Plaintiff's asserted equivalence between the "company" and its shareholders. Rather, in assigning those tasks to the "company," the SEC clearly assigned them to the company's managers and directors, and their subordinates.

CNET Networks, Inc., 954 A.2d 335, 342 (Del. Ch.), *aff'd*, 947 A.2d 1120 (Del. 2008). Plaintiff's contrary contention—that Rule 14a-8 assumes that such "gate-keeper" responsibility can be assigned to shareholders rather than to the board and management—is incorrect.

* * *

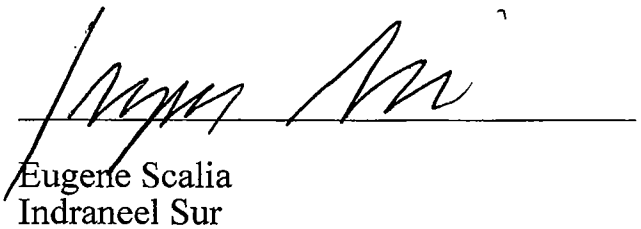
Plaintiff's claim depends on a mistaken reading of federal law. He is not helped by resorting to unprecedented, adventurous readings of state law also.

CONCLUSION

Rule 14a-8 simply does not require EA to yield control of its proxy materials to Plaintiff, and thereby to make it cheaper and more convenient for him to air the policy disagreements he has with the existing proxy rules. The judgment of dismissal is correct and should be affirmed.

Dated: Washington, D.C.
April 22, 2009

GIBSON, DUNN & CRUTCHER LLP



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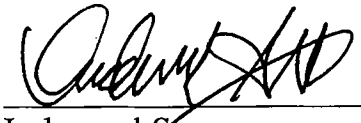
By: 
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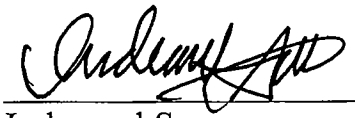
By: 
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