

2020

**EXAMINING
THE SEC'S
PROXY
ADVISOR
RULE**



CENTER FOR CAPITAL MARKETS
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EXAMINING THE SEC'S PROXY ADVISOR RULE

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INTRODUCTION

Proxy advisors, which provide advice on corporate voting matters for institutional investor clients, are an increasingly important fixture in modern corporate governance. As proxy advisors have taken on greater visibility and importance in markets in the United States and around the world, scrutiny of the power and influence of proxy advisors has increased commensurately. Over the last decade, Congress has repeatedly considered the role and regulation of proxy advisors. The same is true at the Securities and Exchange Commission (SEC). Beginning with a 2010 Concept Release and through a series of informal interpretations, notice-and-comment rulemaking, and engagements with proxy advisors, investors, company officials, academics, and others, the SEC has considered questions of proxy advisor conflicts of interest and advice quality. Following this extensive study and analysis, the SEC promulgated a new rule in July 2020 that is designed to increase the transparency, accuracy, and completeness of the information proxy advisors provide to investors making proxy voting decisions (Final Rule).¹

As described in this Report, the Final Rule represents the culmination of a decade-long review and analysis of the role and regulation of proxy advisory businesses. This Report examines the SEC’s rulemaking process that led to the Final Rule and how the SEC responded to concerns aired during the public comment period to narrow the scope of the Proposed Rule² and shift the regulatory approach to a more flexible, principles-based framework. In Part I, we briefly describe the history of the proxy advisory industry in the United States, as well as the criticisms that have accompanied its rise in significance. In Part II, we turn to the SEC’s efforts to address these criticisms through the Proposed Rule noticed in November 2019. Part III discusses the intense response to this rulemaking from both supporters and critics of the proxy advisory industry. Part IV outlines the various modifications the SEC made in the Final Rule, adopted after careful review of the many comments on the Proposed Rule.

1. Exemptions From the Proxy Rules for Proxy Voting Advice, 85 Fed. Reg. 55,082–55,155 (Sept. 3, 2020) (Release No. 34–89,372; File No. S7–22–19, dated July 22, 2020) [hereinafter “Final Rule”], <https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16337.pdf>.
2. Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66,518–66,559 (Dec. 4, 2019) (Release No. 34–87457; File No. S7–22–19, dated Dec. 3, 2019) [hereinafter “Proposed Rule”], <https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24475.pdf>.

Finally, Part V surveys the potential legal challenges to the Final Rule. We conclude that it is unlikely that a federal court would invalidate the Final Rule under the Administrative Procedure Act and related administrative law doctrines. The SEC convincingly demonstrates the need for regulation given the potential for conflicts of interest and poor-quality governance advice in the proxy advisory industry. Furthermore, the likelihood of a successful legal challenge decreased substantially when the SEC thoughtfully made significant changes to its regulatory approach from the Proposed Rule to the Final Rule. In the Final Rule, the SEC embraced a middle-ground approach to regulating proxy advisors—one that responds to the major concerns raised by proxy advisory businesses and their supporters during the notice-and-comment rulemaking process.

Likewise, a legal challenge to the SEC’s interpretation of “solicitation” in Section 14(a) of the Exchange Act to apply to proxy guidance is unlikely to prevail. Congress did not define the term in the statute but, instead, charged the SEC with promulgating rules and regulations “as necessary or appropriate in the public interest or for the protection of investors.” Accordingly, under the seminal *Chevron* deference doctrine, the reviewing court will defer to the SEC’s interpretation of the ambiguous statutory provision so long as the agency’s interpretation is reasonable. Especially in light of the decades of agency and judicial precedent interpreting “solicitation” and the policy purposes that motivate Section 14(a), challengers will be hard pressed to argue that the SEC’s approach to solicitation in the Final Rule is unreasonable.

In sum, the SEC’s Final Rule is a step in the right direction to address deficiencies in the proxy advisory system. Due to the SEC’s decision to embrace a middle-ground regulatory approach, the strong proponents and strong opponents to the Proposed Rule are likely both dissatisfied with the Final Rule as a matter of policy. As a matter of law, however, it is difficult to argue that the SEC failed to engage in reasoned decisionmaking or otherwise acted outside its statutory mandate in promulgating the Final Rule.

HISTORY OF THE PROXY ADVISORY INDUSTRY

A. THE RISE OF THE PROXY ADVISORS

The history of the proxy advisory industry spans more than three decades and owes its vitality to several factors. Markets have become increasingly “institutionalized” over time, with institutional investors making up a greater percentage of market owners compared to individual, “retail” investors. As noted in a 2016 Government Accountability Office (GAO) report, the “increased ownership share that institutional investors hold and the high volume of proxy votes they are responsible for casting has increased demand for proxy advisory firms.”³ Some 70% of shares outstanding in U.S. public companies are owned by institutions, while only about 30% are owned by retail investors.⁴

The number of proposals for shareholders to consider has also increased over time.⁵ That is due in part to increased shareholder activism. But regulatory changes have also played a role. For instance, under Dodd-Frank’s say-on-pay requirement,⁶ shareholders of a publicly-traded companies are asked to provide a non-binding vote to approve or disapprove the companies’ executive compensation plan at least once every three years. More fundamentally, several regulatory actions created demand for proxy advisory services in the first place. The first action was the Department of Labor’s 1988 “Avon Letter” stating that “the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of

3. U.S. Government Accountability Office, Corporate Shareholder Meetings, Proxy Advisory Firms’ Role In Voting And Corporate Governance Practices (Nov. 2016) [hereinafter “2016 GAO Report”], <https://www.gao.gov/products/GAO-17-47>.

4. *Id.* at 13 (citing Broadridge Financial Solutions and PwC’s Governance Insights Center, *2016 Proxy Season Wrap-up*, ProxyPulse. 3d. ed. (2016).

5. Georgeson Proxy Insight reported 30 corporate governance related shareholder proposals in 1987. This total increased to 134 by 1996 and 776 by 2004, but shrank to 236 by 2019. See Georgeson Shareholder Annual Meeting Season Wrap-Up 1996, at 4; Georgeson Annual Corporate Governance Review (2006) at 9; Georgeson Proxy Insight Annual Corporate Governance Review (2019) at 12.

6. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111- 203, § 951, 124 Stat. 1376, 1899 (2010).

proxies appurtenant to those shares of stock.”⁷ Investment advisers subject to this regulation through the Employee Retirement Income Security Act (ERISA) were thus required to vote shares held by ERISA plans, regardless of the materiality of a particular vote at issue.

The SEC followed with the 2003 adoption of Rule 206(4)-6 of the Investment Advisers Act of 1940, which states that it is a “fraudulent, deceptive, or manipulative act, practice or course of business” for an investment adviser to exercise voting authority with respect to client securities, unless the investment adviser: (1) adopts and implements written policies and procedures that are reasonably designed to ensure that the adviser votes client securities in the best interest of clients (including procedures on how the adviser addresses conflicts of interest); (2) discloses to clients how they may obtain information from advisers on how they voted with respect to their securities; and (3) describes to clients the adviser’s proxy voting policies and procedures.⁸ Rule 206(4)-6, adopted because of concerns that conflicts of interest could affect proxy voting,⁹ created direct regulatory support for a market in proxy advisory services. As described by the 2016 GAO report:

According to some industry stakeholders, based on certain interpretations of the rule and subsequent SEC staff guidance, some investment advisers determined that they could discharge their duty to vote their proxies and demonstrate that their vote was not a product of a conflict of interest if they voted based on the recommendations of a proxy advisory firm. As a result, institutional investors tended to outsource their research and voting decisions, which helped to increase the demand for proxy advisory services.¹⁰

Finally, in the year following adoption of Rule 206(4)-6, the SEC issued two no-action letters: one to Egan-Jones Proxy Services (May 27, 2004) and the other to Institutional Shareholder Services, Inc. (Sept. 15, 2004). In these no-action letters, the SEC clarified that an investment advisor could outsource its proxy statement review and proxy voting processes to an “independent third party” such as a proxy advisory firm. The SEC also suggested that investment advisers were not required to make a case-by-case evaluation of proxy advisor conflicts of interest with issuers, but could rely on a proxy voting firm’s general conflicts procedures, which supported the ability of proxy advisory services to maintain corporate governance consulting services for issuers while at the same time providing corporate governance advice to investors.

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7. Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974, Fed. Reg., Vol. 59, No. 145 (July 29, 1994) (describing “Avon letter”), <https://www.govinfo.gov/content/pkg/FR-1994-07-29/html/94-18198.htm>.
 8. Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585, 6586 (Feb. 7, 2003). (Release No. IA–2106; File No. S7–38–02, dated Jan. 31, 2003).
 9. See *Id.* at 6589 (“An adviser may have conflicts that can affect how it votes proxies. For example, the adviser (or its affiliate) may manage a pension plan, administer employee benefit plans, or provide brokerage, underwriting, insurance, or banking services to a company whose management is soliciting proxies. Failure to vote in favor of management may harm the adviser’s relationship with the company. The adviser may also have business or personal relationships with other proponents of proxy proposals, participants in proxy contests, corporate directors or candidates for directorships. For example, the adviser may manage money for an employee group, or an executive of the adviser may have a spouse or other close relative who serves as a director or executive of a company. Our concern with these conflicts and how they affect clients of advisers led us to propose, on Sept. 20, 2002, new rule 206(4)-6 and amendments to rule 204-2.”).
 10. 2016 GAO Report, *supra* note 3, at 14–15.

In the decades since the Avon letter, the passage of Rule 206(4)-6, and the ISS and Egan-Jones no-action letters, the role of proxy advisors has been cemented as a feature of U.S. corporate governance. Proxy advisors perform a variety of undeniably significant governance services for their institutional clients. In its 2010 Concept Release on the U.S Proxy System, the SEC described the most important functions of proxy advisors in helping institutional investors to meet their proxy voting obligations, including:

- Analyzing and making voting recommendations on the matters presented for shareholder vote and included in the issuers' proxy statements;
- Executing votes on the institutional investors' proxies in accordance with the investors' instructions, which may include voting the shares in accordance with a customized proxy voting policy resulting from consultation between the institutional investor and the proxy advisory firm, the proxy advisory firm's proxy voting policies, or the institution's own voting policy;
- Assisting with the administrative tasks associated with voting and keeping track of the large number of voting decisions;
- Providing research and identifying potential risk factors related to corporate governance; and
- Helping mitigate conflict of interest concerns raised when the institutional investor is casting votes in a matter in which its interest may differ from the interest of its clients.¹¹

B. CRITICISMS OF PROXY ADVISORS

Notwithstanding the important functions proxy advisors now perform, they have been the subject of significant criticism as their power has augmented over time. As former SEC Commissioner Daniel Gallagher wrote, these criticisms are focused on two key questions. First, are proxy advisors' recommendations compromised by conflicts of interest (the very concern that led to the adoption of Rule 206(4)-6)? Second, even assuming they are not, do proxy advisors produce accurate, transparent, and useful recommendations?¹²

1. CONCERNS OVER CONFLICTS OF INTEREST

The SEC has identified several potential conflicts of interest to which proxy advisory firms may be susceptible—some of which are a function of the particular business models of proxy advisors. These potential conflicts include: a proxy advisor providing voting advice to its clients on a company's proxy while also providing governance or compensation advice to the company providing advice on a matter in which its affil-

11. Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, 43,009 (July 22, 2010).

12. Daniel M. Gallagher, *Outsized Power & Influence: The Role of Proxy Advisors*, Washington Legal Foundation Critical Legal Issues Working Paper Series, No. 187, at 8 (Aug. 2014), <https://s3.us-east-2.amazonaws.com/washlegal-uploads/upload/legalstudies/workingpaper/GallagherWP8-14.pdf>.

iates or one of its clients has a material interest, such as a business transaction or a shareholder proposal put forward by that client; providing ratings to institutional investors of a company's corporate governance practices while at the same time providing governance advice to that company; and providing advice in cases in which an affiliate of the advisor holds a significant ownership interest in the company, sits on the company's board, or has a relationship with the shareholder presenting the proposal in question.

These concerns were also highlighted in the SEC's 2010 Concept Release, noting that conflicts of interest were perhaps "the most frequently raised concern about the proxy advisory industry."¹³ These concerns have also been the subject of GAO reports in 2007 and 2016, which addressed conflicts of interest within the proxy advisory industry.¹⁴ The 2007 GAO report focused particularly on concerns with the Institutional Shareholder Services group of companies (ISS), noting that ISS provides institutional investor clients with "recommendations for proxy voting and ratings of companies' corporate governance" and also "helps corporate clients develop proposals to be voted on and offers corporate governance consulting services to help clients understand and improve their corporate governance ratings."¹⁵

2. CONCERNS OVER ADVICE QUALITY

The importance of advice quality is underlined by the fact that many institutional investors vote fully, or almost fully, in line with the benchmark policies of the proxy advisors that advise them.¹⁶ The benchmark policies selected by ISS and Glass Lewis thus become the de facto corporate governance standard against which companies are measured, and the introduction of the policies for the upcoming year are a matter of great interest and importance to corporations and corporate governance professionals.¹⁷

The use of benchmarks relates to the difficulty of conducting in-depth analyses of thousands of companies in a relatively short time period. These pressures tend to generate a less time-intensive and more cost-effective one-size-fits-all approach to governance. However, critics of some of the corporate governance positions taken by some proxy advisors argue that some policies seem to be, in the words of the

13. 2010 Concept Release, *supra* note 11, at 43,011.

14. U.S. Government Accountability Office, Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting (June 2007), <https://www.gao.gov/new.items/d07765.pdf> [hereinafter "2007 GAO Report"]; U.S. Government Accountability Office, Corporate Shareholder Meetings: Proxy Advisory Firms' Role in Voting and Corporate Governance Practices (Nov. 2016), <https://www.gao.gov/assets/690/681050.pdf>.

15. 2007 GAO Report, *supra* note 14, at 9–10.

16. See Comments of Paul Rose on File Number 87-22-19, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice (Nov. 19, 2019), <https://www.sec.gov/comments/s7-22-19/s72219-6429308-198569.pdf> (providing data showing how dozens of large institutional investors vote with ISS 99.5% or more of the time); see also TIMOTHY DOYLE, THE REALITIES OF ROBOVOTING 7 (Report for Am. Council for Capital Formation, Nov. 2018), https://accfcorgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_FINAL.pdf (finding that "175 asset managers with more than \$5 trillion in assets under management have historically voted with ISS on both management and shareholder proposals more than 95% of the time").

17. See, e.g., Holly Gregory, John Kelsh & Claire Holland, *ISS and Glass Lewis Policy Updates*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Dec. 3, 2019), <https://corpgov.law.harvard.edu/2019/12/03/iss-and-glass-lewis-policy-updates/>.

scholar Lynn Stout, “governance fads and fancies” that rely on “flawed academic studies.”¹⁸

A benchmark, one-size-fits-all approach necessarily fails to consider the full governance context in which individual firms operate. For example, practitioners Bill Libit and Todd Freier have argued that “[c]orporate governance cannot be properly evaluated without in-depth knowledge and understanding of a company, its management and the industry in which the company operates. Proxy advisory firms’ ‘one-size-fits-all’ approach to corporate governance may have little or no relation to the specific strategic, competitive environment or operational and management issues confronting a particular company.”¹⁹ In a 2015 article published in the *Journal of Law & Economics*, David Larcker, Allan McCall, and Gaizka Ormazabal highlight the risks of poor-quality research and one-size-fits-all metrics:

If investors select proxy advisors on the basis of cost rather than quality of recommendations . . . proxy advisors may not have incentives to conduct rigorous firm-specific research. Also, if proxy advisors can influence enough shareholder votes, boards of directors may be induced to respond by changing executive compensation programs and governance structure in a manner consistent with the recommendations of proxy advisor firms. Unfortunately, if the proxy advisors’ recommendations are inappropriate, these changes can lead to a decrease in shareholder value.²⁰

Another aspect of advice quality concerns accuracy. Some critics of proxy advisors have argued that advisors routinely make errors in the guidance they provide to investors. For example, corporate attorney Frank Placenti reviewed supplemental proxy filings from 2016, 2017, and part of 2018 to evaluate the extent to which registrants identified errors in proxy guidance. The study revealed 107 filings alleging factual, analytical, or other “serious disputes.”²¹ On the other hand, the SEC Investor Advisory Committee has responded that, in context of many thousands of shareholder votes, the number of factual errors is “trivi-

18. Lynn A. Stout, *Why Should ISS Be The New Master Of The Corporate Governance Universe?*, DOW-JONES CORP. GOVERNANCE, Jan. 4, 2006, at 14–15.

19. Bill Libit & Todd Freier, *Proxy Advisory Firms and Corporate Governance Practices: One Size Does Not Fit All*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (June 18, 2014), <https://corpgov.law.harvard.edu/2014/06/18/proxy-advisory-firms-and-corporate-governance-practices-one-size-does-not-fit-all/>.

20. David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J. L. & ECON. 173, 175 (2015).

21. FRANK PLACENTI, ARE PROXY ADVISORS REALLY A PROBLEM? 11 (Report for Am. Council for Capital Formation, Oct. 2018), https://accfcorgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf. The study categorized “factual errors” filings as filings “claiming that the advisor’s reports contained identified factual errors.” “Analytical errors” were from filings “claiming that the advisor’s reports contained identified analytical errors, such as the use of incongruent compensation peer group data or the use of peer groups that inexplicably varied from year to year.” “Serious disputes” were from filings that “identified specific problems with the advisors’ reports often stemming from the ‘one-size-fits-all’ application of the proxy advisors’ general policies. These included support for shareholder proposals seeking to implement bylaw changes that would be illegal under the issuer’s state law of incorporation, inconsistent recommendations with respect to the same compensation plan in multiple years, and other serious disputes.” *Id.*

ally small”; “none of those is shown to be material or to have affected the outcome of the related vote.”²² Nevertheless, registrants have argued that they should have the ability to respond (prior to shareholder voting) to errors resulting in adverse voting guidance from proxy advisors, even if the error is analytical rather than factual.

C. REGULATORY ACTIONS PRIOR TO THE PROPOSED RULE

The debate over the appropriate role and regulation of the proxy advisory industry has become increasingly heated as the role and influence of proxy advisors has grown. Indeed, there is even significant debate over the extent of proxy advisors’ influence over proxy voting. The SEC, as the primary regulator of proxy voting and proxy advisory firms, has spent years considering the merits and risks associated with the proxy advisory industry.

As noted in its 2019 Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, the SEC: issued a concept release in 2010 and sought public comment about “the role and legal status of proxy advisory firms within the U.S. proxy system”; held a roundtable in 2013 on the use of proxy firm advice by institutional investors and investment advisers; issued a Staff Legal Bulletin in 2014 to “provide guidance about the availability and requirements of two exemptions to the federal proxy rules that are often relied upon by proxy advisory firms”; and held a roundtable in 2018 seeking “input on questions that arise regarding the use of proxy advisory firms and their activities.”²³ The SEC also formally withdrew the 2004 no-action letters to Egan-Jones and ISS in 2018.

In 2019, the SEC provided additional clarity on the use of proxy advisors through its Guidance Regarding Proxy Voting Responsibilities of Investment Advisers.²⁴ This Guidance addresses a variety of topics, including: the scope of the investment adviser’s authority and responsibilities to vote proxies; the steps investment advisers could take to demonstrate that they are acting in the interest of a client with respect to proxy voting; general considerations when using proxy advisors; the management of potential factual errors, potential incompleteness, or potential methodological weaknesses in the proxy advisory firm’s analysis; and evaluation of proxy advisory firm services.

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22. Recommendation of the SEC Investor Advisory Committee (IAC) Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals, at 5 (Jan. 24, 2020), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/sec-guidance-and-rule-proposals-on-proxy-advisors-and-shareholder-proposals.pdf>; see also *id.* (“From over 17,000 shareholder votes over three years, the number of possible factual errors identified by companies themselves in their proxy supplements amounts to 0.3% of proxy statements.”).
 23. Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, 84 Fed. Reg. 47,416, 47,416 (Sept. 10, 2019) (Release No. 34–86721, dated Aug. 21, 2019) [hereinafter “2019 SEC Interpretation”], <https://www.govinfo.gov/content/pkg/FR-2019-09-10/pdf/2019-18355.pdf>.
 24. Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 Fed. Reg. 47,420 (Sept. 10, 2019) (Release Nos. IA–5325, IC–33605, dated Aug. 21, 2019) [hereinafter “2019 SEC Guidance”], <https://www.govinfo.gov/content/pkg/FR-2019-09-10/pdf/2019-18342.pdf>.

With the Guidance the SEC seemed to intend to “set a high bar for investment advisors to comply with their fiduciary duties and an intention that they not rely uncritically on third party advice.”²⁵

Congress has also devoted considerable attention to the function and power of proxy advisors. The House and Senate have both held hearings to explore how to regulate the proxy advisory industry.²⁶ Congress has repeatedly considered legislation to regulate proxy advisors. For instance, the Corporate Governance Reform and Transparency Act of 2016 would have required proxy advisors to register with the SEC.²⁷ And the bipartisan Corporate Governance Fairness Act of 2018 would also have required registration of proxy advisors as well as directed the SEC to conduct periodic examinations of proxy advisors.²⁸ Other jurisdictions have considered (and imposed) regulations on proxy advisors. Under the European Union’s Shareholder Rights Directive, for example, proxy advisors are “subject to a code of conduct effectively report on their application of that code” and are required to “disclose certain key information relating to the preparation of their research, advice and voting recommendations and any actual or potential conflicts of interests or business relationships that may influence the preparation of the research, advice and voting recommendations.”²⁹

The SEC’s Proposed Rule and Final Rule thus follow years of formal consideration by Congress, the SEC, and other regulators on the role of proxy advisors and, in particular, the potential for conflicts of interest and poor-quality advice. As discussed in detail below, the SEC’s Proposed Rule attempted to address three aspects of these concerns: (1) the adequacy of disclosure of any actual or potential conflicts of interest that could materially affect the objectivity of the proxy voting advice; (2) the accuracy and material completeness of the information underlying the advice; and (3) the ability of proxy voting advice businesses’ clients to receive information and views from the registrant, potentially contrary to that presented in the advice, in a manner that is consistently timely and efficient.³⁰

25. Frank Placenti, *The SEC’s Evolving Views Regarding Proxy Advisors*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Nov. 23, 2019), <https://corpgov.law.harvard.edu/2019/11/23/the-secs-evolving-views-regarding-proxy-advisors/>.

26. See, e.g., Examining the Market Power and Impact of Proxy Advisory Firms: Hearing Before the House Subcomm. on Capital Markets and Government Sponsored Enterprises, 113th Cong. (2013); Legislative Proposals to Examine Corporate Governance: Hearing Before the Sen. Comm. on Banking, Housing, and Urban Affairs, 115th Cong. (2018) (including legislation that would regulate the proxy advisor industry).

27. Corporate Governance Reform and Transparency Act, H.R. 5311, 114th Cong. (2016). The bill was also reintroduced in 2017 and passed the House in 2018. But it was not taken up in the Senate.

28. Corporate Governance Fairness Act, S. 3614, 115th Cong. (2018).

29. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement, <https://eur-lex.europa.eu/legal-content/EN/TX/?uri=CELEX%3A32017L0828>.

30. Proposed Rule, *supra* note 2, at 66,525.

THE SEC'S PROPOSED RULE: AMENDMENTS TO EXEMPTIONS FROM THE PROXY RULES FOR PROXY VOTING ADVICE

In November 2019, the SEC proposed three significant amendments to its regulations governing the activities of proxy advisors. First, the SEC proposed codifying its position that proxy advice constitutes a “solicitation” for purposes of the Exchange Act and thus, absent an exemption, is subject to certain content and filing requirements. Second, the SEC proposed to exempt proxy advisors from these content and filing requirements on the condition that proxy advisors provide disclosure regarding potential conflicts of interest as well as provide registrants and other soliciting persons an opportunity to review proposed proxy advice before it is disseminated to investors, allowing registrants and others an opportunity to correct errors and provide feedback on the advice. Third, the Proposed Rule clarified the application of Rule 14a-9, the Commission’s proxy solicitation antifraud provision, to proxy advice. Each is discussed in detail in the subparts that follow.

A. PROPOSED CODIFICATION OF THE COMMISSION’S INTERPRETATION OF “SOLICITATION” UNDER RULE 14A-1(L) AND SECTION 14(A)

Under Exchange Act Section 14(a), a person may not “solicit” a proxy of a registered company without complying with numerous regulations governing the timing, content, and filing of the solicitation. The statute does not define “solicitation,” but the SEC has “exercised its rulemaking authority over the years to define what communications are solicitations and to prescribe rules and regulations when necessary and appropriate to protect investors in the proxy voting process.”³¹

In its current form, the definition broadly encompasses a range of communications that may influence proxy voting, including specific requests for a proxy (whether or not accompanied by or included in a formal proxy ballot), any request to execute or not to execute, or to revoke, a proxy, or “[t]he furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.”³² The SEC included the last part—with its expansive language covering any “other communication” that is “reasonably calculated” to result in a proxy voting decision—due to the “recognition that some market participants were distributing written communications designed to affect shareholders’ voting decisions well in advance of any formal request for a proxy that would have triggered the filing and information requirements of the federal proxy rules.”³³

Courts have accepted this expansive view of the meaning of “solicitation.” In *Long Island Lighting Co. v. Barbash*, for example, the Second Circuit found that print and radio advertisements criticizing Long Island Lighting Company management and encouraging citizens to replace the company with a state-run enterprise were “solicitations” within the meaning of the proxy rules.³⁴ Reversing the district court’s ruling that the proxy rules cannot cover communications “appearing in publications of general circulation and that are indirectly addressed to shareholders,” the Second Circuit held that the proxy rules “apply not only to direct requests to furnish, revoke or withhold proxies, but also to communications which may indirectly accomplish such a result or constitute a step in a chain of communications designed ultimately to accomplish such a result.”³⁵ The relevant inquiry, the court held, is whether the communication, “seen in the totality of circumstances,” is “‘reasonably calculated’ to influence the shareholders’ votes,” even in cases where the communication may not be targeting shareholders directly.³⁶

31. *Id.* at 66,521.

32. 17 C.F.R. § 240.14a-1(l).

33. Proposed Rule, *supra* note 2, at 66,521.

34. 779 F.2d 793 (2d Cir. 1985).

35. *Id.* at 795–96.

36. *Id.* at 796.

Furthermore, under the courts’ and the SEC’s understanding, the definition of solicitation includes communications even where the persons communicating with shareholders were not seeking proxy authority for themselves.³⁷ However, the SEC adopted rules providing exemptions from information and filing (but not antifraud) requirements for persons not seeking proxy authority; these rules allow for shareholders to have access to “more sources of information when voting,” while still applying antifraud regulation to such information.³⁸

As noted in the Proposed Rule, the Commission has recognized the application of the proxy solicitation rules to proxy advisory firms “because they provide recommendations that are reasonably calculated to result in the procurement, withholding, or revocation of a proxy and that, as a general matter, the furnishing of proxy voting advice constitutes a solicitation.”³⁹ The Proposed Rule would codify the SEC’s view by including proxy advice within the definition of “solicitation” under the proxy rules. Specifically, the Proposed Rule added a paragraph to Rule 14a-1(l)(1)(iii): “Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.”⁴⁰ Such activities should fall under the definition of a solicitation, the SEC argued, because

the furnishing of proxy voting advice by a person who has decided to offer such advice, separately from other forms of investment advice, to shareholders for a fee, with the expectation that its advice will be part of the shareholders’ voting decision-making process, is conducting the type of activity that raises the investor protection concerns about inadequate or materially misleading disclosures that Section 14(a) and the Commission’s proxy rules are intended to address.⁴¹

The SEC noted in the Proposed Rule that “solicit” did not have a “single, narrow” meaning when Section 14(a) of the Exchange Act was enacted.⁴² Furthermore, it would be inconsistent with the purposes of Section 14(a) to ensure shareholders receive materially complete and accurate information if “persons whose business is to offer and sell voting advice broadly to large numbers of shareholders, with the expectation that their advice will factor into shareholders’ voting decisions, were beyond the reach of Section 14(a).”⁴³ Courts have also recognized that the protections of 14(a) “would be hollow if the statutory provision is in-

37. See Proposed Rule, *supra* note 2, at 66,521; accord Regulation of Communications Among Shareholders, 57 Fed. Reg. 48,276 (Oct. 22, 1992).

38. Proposed Rule, *supra* note 2, at 66,521–66,522.

39. *Id.* at 66,522.

40. *Id.* at 66,557.

41. *Id.* at 66,522.

42. *Id.* at 66,523.

43. *Id.*

terpreted in an overly narrow manner.”⁴⁴

In addition to the codification of the interpretation of proxy advice as a solicitation, the SEC provided an exception in the Proposed Rule for responses to unprompted requests for proxy advice. The SEC believed such an exemption would be appropriate because compliance with the information, filing, and conflicts-of-interest regulations are “ill-suited for a person who receives an unprompted request from a client” because such a person “is unlikely to anticipate the need to establish the internal processes necessary to comply with [the Proposed Rule].”⁴⁵

B. PROPOSED AMENDMENTS TO RULE 14A-2(B): CONFLICTS OF INTEREST AND NOTICE OF PROXY VOTING ADVICE AND RESPONSE

The proxy rules generally require proxy solicitations to be accompanied by certain disclosures, including description of matters to be acted upon, information about the persons making the solicitation, and their interest in the matters to be acted upon, among other things.⁴⁶ The proxy statement and all solicitation materials must also be timely filed with the SEC. However, over the years the SEC has established a number of exemptions so that many solicitations are exempted from the filing and disclosure requirements required under the proxy rules.⁴⁷

The proxy advisory industry has typically relied on two such exemptions. First, Rule 14a-2(b)(1) (commonly described as the “solicitation exemption”) exempts “[a]ny solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another’s behalf, the power to act as a proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.”⁴⁸

44. *Id.* at 66,523 n.50. The SEC cites the well-known case *SEC v. Okin*, in which Judge Learned Hand wrote that a manager’s letter sent to shareholders, even though not specifically requesting proxies, could nonetheless be considered a solicitation. Judge Hand framed the question as whether a “solicitation” must seek a “proxy, power of attorney, consent, or authorization,” or whether it “extends to any other writings which are part of a continuous plan ending in solicitation and which prepare the way for its success.” *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943). In a much-cited passage, he writes:

We have no doubt that the power extends to such writings; were it not so, an easy way would be open to circumvent the statute; one need only spread the misinformation adequately before beginning to solicit, and the Commission would be powerless to protect shareholders. The earlier stages in the execution of such a continuous purpose must be subject to regulation, if the purpose of Congress is to be fully carried out.

Id.

45. Proposed Rule, *supra* note 2, at 66,523.

46. The proxy statement requirements are set out in Schedule 14A, 17 C.F.R. § 240.14a-101.

47. Note, however, that the antifraud protections of Rule 14a-9 still apply to these solicitations.

48. 17 C.F.R. § 240.14a-2(b)(1).

Second, Rule 14a-2(b)(3) (described as the “business relationship exemption”) exempts proxy advice if the advisor: (1) “renders financial advice in the ordinary course of his business”; (2) “discloses to the recipient of the advice any significant relationship with the registrant or any of its affiliates, or a security holder proponent of the matter on which advice is given, as well as any material interests of the person in such matter”; (3) “receives no special commission or remuneration for furnishing the proxy advice from any person other than the recipient of the advice and other persons who receive similar advice”; and (4) does not furnish the advice “on behalf of any person soliciting proxies or on behalf of a participant in a contested election.”⁴⁹ Even if a proxy advisor is able to rely on these exemptions, however, the prohibition on false and misleading statements in Rule 14a-9 continues to apply.

These exemptions are longstanding. Rule 14a-2(b)(3) dates from 1979,⁵⁰ and the SEC confirmed that the rule applies to proxy advisory firms that render only proxy voting advice in 1992.⁵¹ The exemptions thus predated important shifts in rulemaking and policy that gave rise to the modern proxy advisory industry, such as the 2003 implementation of Rule 206(4)-6. And, as stated by the SEC in the Proposed Rule release, these exemptions “were adopted by the Commission before proxy voting advice businesses played the significant role that they now do in the proxy voting process and in the voting decisions of investment advisers and other institutional investors.”⁵² The SEC noted, for example, that ISS has about 2,000 institutional clients,⁵³ while its main competitor, Glass Lewis, has “1,300+ clients, including the majority of the world’s largest pension plans, mutual funds, and asset managers, who collectively manage more than \$35 trillion in assets.”⁵⁴ The Proposed Rule thus sought to recalibrate the exemptions “in light of the substantial role that proxy voting advice businesses have in the voting decisions of their clients, who often vote on behalf of investors,” while still recognizing the proxy advisors play a valuable role in the proxy voting process and should not be required to “comply with the filing and information requirements of the proxy rules to the same extent as non-exempt soliciting persons, provided other measures are in place to protect investors.”⁵⁵

The Proposed Rule attempted to balance these concerns by conditioning the exemption under Rules 14a2(b)(1) and (3) upon certain measures designed to mitigate potential conflicts of interest, including ad-

49. *Id.* § 240.14a-2(b)(3).

50. Shareholder Communications and Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, 44 Fed. Reg. 68,769 (Nov. 29, 1979).

51. Regulation of Communications Among Shareholders, 57 Fed. Reg. 48,276 (Oct. 22, 1992); see also Concept Release, *supra* note 11.

52. Proposed Rule, *supra* note 2, at 66,523.

53. *Id.* at 66,520 n.18.

54. *Id.* (quoting Glass Lewis website).

55. *Id.* at 66,525.

ditional disclosures and governance practices.⁵⁶ The conditions laid out in the Proposed Rule included two core obligations. First, proxy advisors would be required to provide additional disclosures relating to conflicts of interest. Second, proxy advisors would be required to provide management the opportunity to comment on or correct any of the advice provided by the proxy advisors.

1. CONFLICTS OF INTEREST

Rule 14a-2(b)(1) had no conflicts disclosure requirement, but, as noted above, the SEC’s advice exemption under Rule 14a-2(b)(3) required advisors to disclose to the recipient of the advice “any significant relationship with the issuer or any of its affiliates, or a shareholder proponent of the matter on which advice is given, as well as any material interest of the advisor in such matter.”⁵⁷ The Proposed Rule suggested the disclosure currently provided by proxy advisors is inadequate, and that “the voting decisions of persons who rely on these businesses would be better informed if they received information sufficient for them to understand and assess these potential risks and measure.”⁵⁸ Noting comments from various observers, the SEC also stated that the conflicts disclosures provided by proxy advisors are “vague or boilerplate disclosures,” and that “more specific, prominent disclosure about conflicts is needed to enable clients to make a more informed assessment of proxy voting advice businesses’ voting advice.”⁵⁹

The Proposed Rule sought to remedy these deficiencies by requiring additional disclosures that focus on providing “material” information about the nature of the relationships that may create conflicts, in addition to specifying that Rule 14a-2(b)(1) is conditioned on these enhanced disclosures. The SEC stressed in the Proposed Rule (and later in the Final Rule, as well as in some commissioners’ comments on the Final Rule) that the focus on materiality in the Proposed Rule creates a “principles-based requirement to elicit disclosure of any other information regarding the interest, transaction, or relationship that would be material to a reasonable investor’s assessment of the objectivity of the proxy voting advice.”⁶⁰ Further, the SEC advised proxy advisers that the disclosures should be “sufficiently detailed” so that clients can understand the nature and scope of potentially conflicted interests, transactions, or relationships, and should include

56. The SEC identified three goals for the conditions:

(i) improve proxy voting advice businesses’ disclosures of conflicts of interests that would reasonably be expected to materially affect their voting advice, (ii) establish effective measures to reduce the likelihood of factual errors or methodological weaknesses in proxy voting advice, and (iii) ensure that those who receive proxy voting advice have an efficient and timely way to obtain and consider any response a registrant or certain other soliciting person may have to such advice.

Id.

57. Shareholder Communications and Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, 44 Fed. Reg. 68,769, 68,770 (Nov. 29, 1979).

58. Proposed Rule, *supra* note 2, at 66,525–66,526.

59. *Id.* at 66,526.

60. *Id.*

discussion of the policies and procedures used to mitigate the potential conflicts.⁶¹

2. REGISTRANTS' AND OTHER SOLICITING PERSONS' REVIEW OF PROXY VOTING ADVICE AND RESPONSE

A frequently expressed complaint from public companies is the difficulty in addressing factual or methodological errors in the advice disseminated by proxy advisory businesses. In the Proposed Rule, the SEC noted that these concerns are compounded by several other features of the proxy advisory business, including the typically narrow window of time between when advice is given to investors and the voting deadline. First, companies argue that they “lack an adequate opportunity to review proxy voting advice before it is disseminated.”⁶² Second, there are not “meaningful opportunities to engage with the proxy voting advice businesses and rectify potential factual errors or methodological weaknesses in the analysis underlying the proxy voting advice before votes are cast,”⁶³ particularly for smaller registrants. Finally, companies argue that because proxy voting advice typically is delivered to the clients “very shortly before a significant percentage of votes are cast and the meeting held,” companies are not able to dispute errors or contest methodological errors or assumptions “in a timely and effective way.”⁶⁴

The SEC also noted, however, that proxy advisors have put in place some mechanisms to facilitate communications between the advisory firms and company management. ISS, for example, offers S&P 500 companies the opportunity to review a draft of its voting advice before it is sent to clients. Glass Lewis, meanwhile, allows participating companies to review a “data-only version of its voting advice” before it is sent to clients, and has also created a “Report Feedback Statement” program to allow “public companies

61. *Id.* at 66,526–66,527. The SEC sought for standardized disclosures that will help clients compare proxy advisory services:

We believe that by requiring proxy voting advice businesses to provide standardized disclosure regarding conflicts of interest, clients of these businesses would be in a better position to evaluate these businesses’ ability to manage their conflicts of interest, both at the time the proxy voting advice business is first retained and on an ongoing basis.

Id. at 66,527. This explanation underscores the SEC’s interest in promoting competition among proxy advisors for the benefit of investor clients, as it later noted in the section on Effects on Efficiency, Competition, and Capital Formation:

In addition to potentially increasing demand for voting advice from proxy voting advice businesses by establishing requirements that promote accuracy and transparency in proxy voting advice, the requirements that promote accuracy and transparency in proxy voting advice could stimulate competition among proxy voting advice businesses with respect to the quality of advice. In particular, clients of proxy voting advice businesses may be better able to assess conflicts and the accuracy of advice, which could, in turn, cause proxy voting advice businesses to compete more on those dimensions.

Id. at 66,550. The SEC noted, however, that “[b]ecause disclosure under the proposed amendment occurs within the context of private business relationships rather than being public disclosure, this effect on competition is limited to the extent proxy voting advice business clients would use more than one proxy voting advice business.” *Id.* at 66,550 n.260. Charles Calomiris and Joseph Mason have also expressed concern about the ability of competition alone to pressure proxy advisors to provide better quality advice. See Charles W. Calomiris & Joseph R. Mason, *Conflicts of Interest, Low-Quality Ratings, and Meaningful Reform of Credit and Corporate Governance Ratings*, Am. Enterprise Inst. Working Paper (Apr. 14, 2010), <https://www.aei.org/wp-content/uploads/2011/10/conflictsofinterestlowqualityratings.pdf>.

62. Proposed Rule, *supra* note 2, at 66,529.

63. *Id.*

64. *Id.*

and shareholder proponents the opportunity to express differences of opinion they may have with Glass Lewis' research."⁶⁵

The SEC noted, however, that smaller registrants are often not given the opportunity to review the advice before it is sent to clients, and that registrants are typically only given a "short period of time, sometimes with little advance notice," to provide feedback to proxy advisors.⁶⁶ And, because many votes are cast "within a few days or less of the proxy voting advice business's release of its proxy voting advice" (and sometimes through automated voting processes), companies are not able to provide timely responses to factual or methodological errors in the voting advice.⁶⁷

The Proposed Rule attempted to create a mechanism to "foster enhanced engagement" between proxy advisors, registrants, and other soliciting persons, with the goal of improving the accuracy, transparency, and completeness of information available to voters.⁶⁸ Under proposed Rule 14a-2(b)(9)(ii), as a condition to the exemptions in Rules 14a-2(b)(1) and 14a-2(b)(3), proxy advisors would have been required to provide to the registrant (or other soliciting person), for its "review and feedback," a copy of the proxy voting advice the proxy advisor intended to deliver to its clients. The length of this review and feedback period would have depended on how early the registrant filed its definitive proxy statement. If the registrant filed its statement at least 45 calendar days before the security holder meeting date, the review and feedback period would have been no less than five business days. If the registrant filed its statement less than 45 calendar days, but at least 25 calendar days, before the security holder meeting date, the review and feedback period would have been no less than three business days. If definitive proxy statement is filed less than 25 calendar days before the date of the meeting, the proxy advisor is not required to provide its voting advice to registrant. Finally, no earlier than the review and feedback period, and no later than two business days prior to delivery of the proxy voting advice to its clients, proxy advisors would have been required to provide a final notice of proxy voting advice (including a copy of the advice provided to clients), as well as any revisions to such advice made after the review and feedback period.⁶⁹

65. *Id.* at 66,529.

66. *Id.* at 66,529–66,530.

67. *Id.* at 66,530. The SEC noted that proxy advisors will sometimes provide alerts to clients where there has been a material error in their voting advice, but "such policies result in the proxy voting advice businesses, not the client, determining whether the errors or information are material to a voting decision and sharing such information only after their advice has already been published." *Id.* at 66,530.

68. *Id.*

69. *Id.* at 66,558 (Proposed § 240.14a-2(b)(9)(ii)).

3. RESPONSE TO PROXY VOTING ADVICE BY REGISTRANTS AND OTHER SOLICITING PERSONS

The Proposed Rule also provided registrants and other soliciting persons with the option to require that proxy advisors include with their advice a hyperlink directing the voter to “a written statement prepared by the registrant that sets forth its views on the advice.”⁷⁰ While noting that existing rules already permit registrants to file supplementary proxy materials to respond to negative voting recommendations, the SEC nonetheless argued that voting often takes place shortly after clients receive the voting advice, so supplemental materials will not reach many voters before a decision has been made and executed.⁷¹

The SEC recognized that “immaterial and unintentional” failures by proxy advisers to meet the conditions could result in the loss of the exemptions under Rules 14a-2(b)(1) or 14a-2(b)(3). The Proposed Rule thus included a provision stating that a proxy advisor would not lose its exemption so long as the proxy advisor made a good faith and reasonable effort to comply, and, to the extent that it was feasible to do so, the proxy advisor used reasonable efforts to substantially comply with the condition as soon as practicable after it became aware of its noncompliance.⁷² The SEC also clarified in the Proposed Rule that a failure to comply with Rule 14a-2(b)(9) does not create a private right of action against proxy advisors.⁷³

C. PROPOSED AMENDMENTS TO RULE 14A-9

As a final piece of the Proposed Rule, the SEC proposed to amend the note to Rule 14a-9. The text of the rule itself would remain the same, however, and would continue to apply to solicitations. In the Commission Interpretation on Proxy Voting Advice, quoted in the Proposed Rule, the SEC stated that:

Any person engaged in a solicitation through proxy voting advice must not make materially false or misleading statements or omit material facts, such as information underlying the basis of its advice or which would affect its analysis and judgments, that would be required to make the advice not misleading. For example, the provider of the proxy voting advice should consider whether, depending on the particular statement, it may need to disclose [certain] types of information in order to avoid a potential violation of Rule 14a-9.⁷⁴

70. *Id.* at 66,533. Proposed § 240.14a-2(b)(9)(iii) reads:

If requested by the registrant or any other person conducting a solicitation (other than a solicitation exempt under §240.14a-2) prior to expiration of the period described in paragraph (b)(9)(ii) of this section, the proxy voting advice business shall include in its proxy voting advice and in any electronic medium used to deliver the proxy voting advice an active hyperlink or any other analogous electronic medium that leads to the registrant’s or other soliciting person’s, as applicable, statement regarding the proxy voting advice.

Id. at 66,558.

71. *Id.* at 66,533.

72. *Id.* at 66,558 (Proposed § 240.14a-2(b)(9)(iv)).

73. *Id.* at 66,535.

74. 2019 SEC Interpretation, *supra* note 23, at 47,419.

While the text of the Rule 14a-9 would remain unchanged—and continue to prohibit false or misleading statements or omissions—the Proposed Rule sought to amend the note following the rule by adding an additional example of an omission that could be considered misleading:

Failure to disclose material information regarding proxy voting advice covered by §240.14a-1(l)(1)(iii) (A), such as the proxy voting advice business’s methodology, sources of information, conflicts of interest or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.⁷⁵

The SEC’s inclusion of the example stemmed in part from concerns that proxy advisors were making negative vote recommendations “based on their evaluation that a registrant’s conduct or disclosure is inadequate,” but not clarifying that the negative recommendation was based on the *proxy advisor’s* standards, rather than on a failure of the company to meet the SEC’s conduct or disclosure requirements.⁷⁶

The SEC noted in the Proposed Rule that the inclusion of the fifth example was not meant to discourage proxy advisors from creating and applying standards more stringent than the SEC’s, and indeed, clients themselves may create and apply their own more stringent disclosure and governance standards. The example was merely intended to provide full, adequate disclosure of the basis for a voting recommendation.⁷⁷

75. Proposed Rule, *supra* note 2, at 66,558–66,559.

76. *Id.* at 66,538. The SEC argued:

If the use of the criteria and the material differences between the criteria and the applicable Commission requirements are not clearly conveyed to proxy voting advice businesses’ clients, there is a risk that the clients may make their voting decisions based on a misapprehension that a registrant is not in compliance with the Commission’s standards or requirements. Similar concerns exist if, due to the lack of clear disclosures, clients are led to mistakenly believe that the unique criteria used by the proxy voting advice businesses were approved or set by the Commission.

Id.

77. *Id.*

THREE

PROPOSED RULE: COMMENTS AND CONCERNS

The SEC issued its Final Rule on July 22, 2020. This Part describes the comments received during the SEC's comment period from November 2019 to July 2020. A thorough discussion of these comments is essential to evaluating potential challenges to the Final Rule, as many features of the Proposed Rule were adopted in the Final Rule, yet the SEC significantly modified other features based on comments.

The SEC received hundreds of comment letters on the Proposed Rule, including letters from members of Congress, investment managers, proxy advisors, corporate managers, academics, as well as the general public.⁷⁸ SEC Commissioners held dozens of in-person and telephonic meetings with investment advisers, proxy advisors, and company managers.⁷⁹ The SEC also included with the comment letters a memorandum from the SEC's Division of Economic and Risk Analysis that provides "a tabular approximation of the number of instances registrants indicated concerns over the 2016-2018 period with respect to proxy voting advice in the additional soliciting materials reviewed by the staff."⁸⁰ As described below, this analysis quantified the extent of concerns with inaccurate information in the proxy advice provided to voters.

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78. By the date of the filing of the Final Rule, the SEC had received 667 individual letters. Comments on Proposed Rule: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice [Release No. 34-87457; File No. S7-22-19], <https://www.sec.gov/comments/s7-22-19/s72219.htm#comments>. The SEC received four form letters arguing against the SEC's rules, stating, among other things, that the rules "entrench management and deeply undermine shareholder votes" and that the rules were like a political system in which a voter would be required "to first submit my proposal [voting against the politician] to the current politician in power and I would open myself to fraud lawsuits if the politician didn't like what I said." S7-22-19 Letter Type A, <https://www.sec.gov/comments/s7-22-19/s72219-typea.htm>. The SEC received 116 form letters supporting the rule, stating appreciation that the rule proposal "would shine a light on proxy firms' conflicts of interest so that fund managers know the risk they're taking when they stake my money on the firms' advice. I'm also glad you're requiring these firms to let companies check for mistakes and respond to inaccurate recommendations before their reports go out." S7-22-19 Letter Type B, <https://www.sec.gov/comments/s7-22-19/s72219-typeb.htm>.
79. The SEC recorded 87 meetings between advisors and companies and the offices of Chairman Clayton, Commissioner Jackson, Commissioner Lee, Commissioner Pierce, Commissioner Roisman, and other SEC officials.
80. See Memorandum from the Division of Economic and Risk Analysis Regarding Data Analysis of Additional Definitive Proxy Materials Filed by Registrants in Response to Proxy Voting Advice, at 1 (Jan. 16, 2020), <https://www.sec.gov/comments/s7-22-19/s72219-6660914-203861.pdf>.

A. COMMENTS ON PROPOSED AMENDMENTS TO THE DEFINITIONS OF “SOLICIT” AND “SOLICITATION”

Some comments in support of the Proposed Rule’s codification of “solicit” and “solicitation” noted that the definition, as amended, properly included information of the type Congress intended Section 14(a) to address. Among other things, supporters noted that the analysis of what constitutes a solicitation “should not turn on whether the proxy voting advice business’s voting recommendations are based on an investor’s custom policy or the proxy voting advice business’s benchmark policy.”⁸¹ Some commenters suggested clarifying that the definition includes any reports and ratings by environmental, social, sustainability, or governance ratings firms.⁸²

Some commenters in opposition argued that the SEC does not have the authority to regulate proxy advisors under Section 14(a) or any other provision of the Exchange Act. Others suggested that proxy advice differs from proxy solicitation in that “proxy solicitors play an advocacy role on behalf of an interested party, whereas proxy voting advice businesses are independent third parties, hired by shareholders to provide objective advice that the recipients are not required to follow.”⁸³ Two proxy advisory firms, Segal Marco and ProxyVote Plus, asserted in their comments that under the Proposed Rule their activities would not constitute solicitations because they vote on behalf of clients rather than providing them with research reports and voting recommendations.

Some commenters suggested that the Proposed Rule would increase the costs of providing proxy advice (including through increased litigation costs) and could potentially chill shareholder communication. Other commenters argued that the SEC had not provided “reliable evidence” that proxy advisory firms present an investor protection risk sufficient to justify the proposed amendment to the definition. Still other commenters sought to narrow the scope of the definition. Some argued to exclude advice based on custom policies. Others to distinguish between proxy advisors and voting agent businesses, which merely execute votes based on client guidelines but do not provide solicitations in the form of proxy advice. And yet others to clarify that “data and research that may inform a proxy analysis or be described in a proxy research report but that is marketed separately to investor” should not be considered a solicitation. Finally, others requested that the SEC clarify that ordinary-course-of-business communications by management-consulting firms, lawyers, accountants, and broker-dealers should not be considered solicitations under the proposed amendments.⁸⁴

81. Final Rule, *supra* note 1, at 55,089.

82. *Id.*

83. *Id.* at 55,090.

84. *Id.*

ISS's comment letter noted that the exclusion of proxy voting advice furnished only in response to an unprompted request would be counterproductive to investor protection: "Subjecting experts who have the skill and resources to provide accurate and independent proxy advice to additional regulation, while allowing others, with no relevant expertise, to furnish ad hoc, 'drive-by' advice belies the asserted investor protection goal of this rulemaking."⁸⁵

B. COMMENTS ON AMENDMENTS TO RULE 14A-2(B): CONFLICTS OF INTEREST

The SEC noted that it received comments in support of conflicts of interest disclosure from many parties, including some who were generally opposed to the Proposed Rule as a whole.⁸⁶ Some commenters argued that proxy advisors do not adequately disclose and mitigate potential conflicts of interest. Others argued that the amendments were not justified and would impose unnecessary costs and burdens on proxy advisors and their clients, and that existing disclosures and mitigation mechanisms were appropriate and sufficient.⁸⁷

Further, some asserted that any additional costs "could have a detrimental effect on competition in an industry that is already cost-prohibitive for new entrants."⁸⁸ Commenters also proposed a variety of suggested amendments to the Proposed Rule to expand the required disclosures, require certain detailed disclosures, or take a more principles-based approach that would focus on the materiality of the potential conflicts of interest.⁸⁹

85. Comments of Gary Retelny, President and CEO, Institutional Shareholder Services Inc. [hereinafter "ISS Letter"], <https://www.sec.gov/comments/s7-22-19/s72219-6732023-207470.pdf>.

86. CalSTRS writes, for example:

CalSTRS is supportive of one aspect of the proposal. We agree that conflict of interest disclosure is important for a well-functioning and unbiased proxy voting system. Investors should be informed when there may be potential conflicts of interest that could affect proxy advisor recommendations. Investors need confidence that the research being considered when voting is unbiased and fact based. However, we do not believe the SEC needs to create a new regulatory structure to enforce such disclosure.

Comments of Aeisha Mastagni, Portfolio Manager, California State Teachers' Retirement System (CalSTRS), <https://www.sec.gov/comments/s7-22-19/s72219-6744089-207898.pdf>.

87. ISS noted, for example, that "the most vocal critics of ISS in this area are those who speak on behalf of corporate management, and not the investors who rely on ISS' research and vote recommendations." ISS Letter, *supra* note 85, at 32.

88. Final Rule, *supra* note 1, at 55,098.

89. *Id.*

C. COMMENTS ON PROPOSED REVIEW OF AND RESPONSE TO PROXY VOTING ADVICE BY REGISTRANTS AND OTHER SOLICITING PERSONS

The response to the Proposed Rule was strongest with respect to the review and feedback rule proposals. Some commenters expressed support for the provisions, noting that the changes would “improve the completeness, accuracy, and reliability of the information underlying the voting advice” as well as “ameliorate the incidence of errors, mistakes, and deficiencies” in voting advice.⁹⁰ Commenters also expressed support for set amounts of time to review and comment on proxy advice, as some registrants argued that under current practices they did not have sufficient opportunity to meaningfully engage with proxy advisors before voters acted on proxy advice. Some commenters in support of the Proposed Rule also disagreed with other commenters’ suggestion that the Proposed Rule would compromise proxy advisors’ independence—with some “pointing to the fact that a number of registrants were already participating in advance review programs offered by proxy voting advice businesses.”⁹¹

Many commenters opposed this aspect of the Proposed Rule, however, arguing that there was not compelling evidence of errors in proxy advice. Opposing comments also noted that clients of proxy advisors are generally satisfied with the advice they receive, and the complaints come primarily from registrants and their advocates.⁹² Some commenters were also concerned that requiring advance notice of proxy advice would provide an “unfair advantage” to company management in disputed proxy matters. And, some suggested that giving registrants the ability to review and comment on proxy advice would inappropriately insert the SEC and management into intra-shareholder communications, contra the SEC’s stated position in an earlier release.⁹³ Some raised the concern of an increased risk of insider trading, while others doubted the effectiveness of the Proposed Rule in safeguarding confidentiality.

90. *Id.* at 55,103.

91. *Id.* See, e.g., Comments of Neil A. Hanson, Vice President, Investor Relations and Secretary, Exxon Mobil Corporation (Feb. 3, 2020), <https://www.sec.gov/comments/s7-22-19/s72219-6742834-207796.pdf>.

92. Final Rule, *supra* note 1, at 55,104.

93. See Regulation of Communications Among Shareholders, 57 Fed. Reg. 48,276 (Oct. 22, 1992). There, the SEC stated:

A regulatory scheme that inserted the Commission staff and corporate management into every exchange and conversation among shareholders, their advisors and other parties on matters subject to a vote certainly would raise serious questions under the free speech clause of the First Amendment, particularly where no proxy authority is being solicited by such persons. This is especially true where such intrusion is not necessary to achieve the goals of the federal securities laws. The purposes of the proxy rules themselves are better served by promoting free discussion, debate and learning among shareholders and interested persons, than by placing restraints on that process to ensure that management has the ability to address every point raised in the exchange of views.

Id. at 48,279.

Many commenters expressed concern that the Proposed Rule would negatively impact the timely delivery of proxy advice to clients, create “numerous logistical and practical challenges that would be highly disruptive to the proxy voting system,” and would impose significant costs on proxy advisors and their clients.⁹⁴ These challenges and costs could result in increased barriers to entry in the proxy advisory market, thereby limiting consumer choice. Others expressed concern that the Proposed Rule would reduce shareholder voting and the utility of proxy advice, which could be “watered down to lessen the risk of litigation.”⁹⁵

Some commenters suggested changes to the Proposed Rule that would, among other things, shorten the review periods, limit review to factual information, and allow registrants to opt-in to the review and feedback period. Glass Lewis suggested a more principles-based approach that would require proxy advisors to “maintain policies and procedures that provide registrants (and certain other soliciting persons) a meaningful opportunity to comment on proxy advice and final notice of any proxy advice,” with Staff or Commission guidance filling in the timing and other elements.”⁹⁶

Finally, although registrants generally supported the proposed response rules, other commenters raised concerns about “costs and delays in the timely receipt of advice” if the Proposed Rule were enacted.⁹⁷ Some suggested providing more time for registrants to provide responses, and suggested that proxy advisors not permit pre-populated or automated voting where a company has responded to a proxy advisor’s adverse recommendation.⁹⁸

D. COMMENTS ON THE AMENDMENTS TO RULE 14A-9

Commenters in favor of the additional example in the note to Rule 14a-9 argued that the amendment would make proxy advisors more accountable for their advice and incentivize them to “provide more robust information about their methods and sources so that their clients would be in a better position to assess the businesses’ recommendations and make informed voting decisions.”⁹⁹ Commenters opposed to the amendment argued, among other things, that proxy advisors would face legal uncertainty and heightened litigation risk; two commenters suggested that the amendment may be prohibited by the First Amendment.¹⁰⁰

94. Final Rule, *supra* note 1, at 55,105.

95. *Id.*

96. Comments of Kevin Cameron, Executive Chair, Glass Lewis (Feb. 3, 2020), <https://www.sec.gov/comments/s7-22-19/s72219-6745349-207938.pdf>.

97. Final Rule, *supra* note 1, at 55,106.

98. *Id.* at 55,160–55,161.

99. *Id.* at 55,119.

100. *Id.* at 55,120.

FOUR

FINAL RULE

In the Final Rule, the SEC made considerable effort to discuss and respond to comments, not only in the sections describing the comments generally (as discussed above), but also in explaining the SEC's decisions with respect to the text of the Final Rule. In this Part, each of the four new rules that make up the Final Rule will be discussed in turn.

A. THE CODIFICATION OF PROXY ADVICE AS SOLICITATION

The Final Rule embraces the Proposed Rule's change to Rule 14a-1(l)(1)(iii) to clarify that the terms "solicit" and "solicitation" include:

Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.¹⁰¹

The Final Rule asserts that proxy advice is the kind of activity that Section 14(a) and the Commission's proxy rules are designed to address, "with their focus on the information received by shareholders as part of the voting process."¹⁰² The SEC further clarified that as proxy advisors produce custom or specialty policies for clients, each of those separate policies is a distinct solicitation under Rule 14a-1(l)(1)(iii)(A).

Most of the SEC's discussion focuses on the statutory basis for the codification. The rulemaking thus not only responds to the comment letters received after publication of the Proposed Rule, but also to the ISS lawsuit challenging, among other things, the SEC's authority to include proxy advice within the meaning of the term "solicitation." The Final Rule responds to ISS's letter specifically, which stated that the amendments would be "contrary to (1) the legislative history of Section 14(a), (2) the case law that has construed the terms 'solicit' and 'solicitation' under Section 14(a) and Rule 14a-1(l), and (3) the plain meaning of the term 'solicit.'"¹⁰³

101. *Id.* at 55,154.

102. *Id.* at 55,091.

103. *Id.* at 55,092 (citing ISS Letter, *supra* note 85).

The SEC noted in its discussion that the structure of Section 14(a) grants the SEC “broad authority,” and provides the SEC with the authority to develop rules to regulate proxy solicitation “as necessary or appropriate in the public interest or for the protection of investors.”¹⁰⁴ The terms “solicit” and “solicitation” are undefined, and the Exchange Act gives the SEC the power to “define technical, trade, accounting, and other terms used in this chapter, consistently with the provisions and purposes of this chapter.”¹⁰⁵

The SEC rejected a narrow meaning of “solicitation” as merely “endeavoring to obtain,” a common dictionary definition. While some commenters argued that for a communication to be a “solicitation,” the alleged solicitor must have a stake or preference in the outcome, the SEC disagreed. Looking to legislative history as well as the plain meaning of the word “solicit” at the time of the enactment of the Exchange Act, the SEC argued that the term “solicit” had meanings that “did not depend on the interest or subjective intent of the person engaging in the solicitation,” including the notion that to “solicit” means to “move to action”; “what matters” under this definition “is not the subjective intent to obtain a proxy, but rather the effect on a recipient’s proxy vote.”¹⁰⁶

In choosing between a meaning focused on the intent of the communicator, on the one hand, and the effect on the recipient of the communication, on the other, the SEC argued that the latter is more consistent with the purposes of Section 14(a). After all, “any inducement that may move a shareholder to vote a proxy in a certain way implicates the Commission’s charge to ensure that necessary and appropriate regulations are in place for the protection of investors.”¹⁰⁷ The SEC also described legislative history and well-established case law supporting a broad reading of the terms “solicit” and “solicitation,” arguing that injecting a requirement of subjective intent of the communicator runs counter to the case law on solicitation. As noted above, the SEC’s position for over 60 years has been that a solicitation includes “communication to security holders under circumstances reasonably calculated to result in the procurement, execution, or revocation of a proxy,”¹⁰⁸ a definition which has held up on repeated legal challenges throughout its history.

The SEC noted that the understanding that proxy advice falls within this definition has been fixed since a 1964 release,¹⁰⁹ and has been reiterated in subsequent releases over the years. The SEC referred to past communications by ISS and Glass Lewis staff implicitly and explicitly acknowledging the application of

104. *Id.*

105. 15 U.S.C. 78c(b).

106. Final Rule, *supra* note 1, at 55,092.

107. *Id.*

108. 17 C.F.R. § 240.14a-1(l)(1)(iii)

109. Broker-Dealer Participation in Proxy Solicitations, 29 Fed. Reg. 341 (Jan. 15, 1964). The SEC specifically cited the following: “Material distributed during a period while proxy solicitation is in progress, which comments upon the issues to be voted on or which suggests how the stockholder should vote, would constitute soliciting material.” *Id.* at 341.

Section 14(a) to their communications.¹¹⁰ The fact that proxy advisors are operating under the assumption that their communications constitute solicitations suggests that “any impact from codifying this aspect of the definition of a solicitation likely is already reflected in the manner in which proxy voting advice businesses’ provide their services and the pricing thereof,” and thus is not likely to impose significant additional costs, chill shareholder communications, or create additional litigation risk.¹¹¹

Finally, the SEC retained the exclusion from the definition of “solicitation” for “any proxy voting advice by a person who furnishes such advice only in response to an unprompted request.”¹¹² The SEC believes the exclusion is appropriate because “a person that provides proxy voting advice only in response to unprompted requests and does not market its expertise in such services is less likely to present an investor protection or market integrity concern,” and one-off advice “lacks the system-wide significance of advice provided by proxy voting advice businesses who, as described above, have come to occupy a unique and important position in that process.”¹¹³

B. CONFLICTS OF INTEREST

As with the Proposed Rule, the SEC adopted a principles-based approach in formulating its Final Rule on conflicts of interest.¹¹⁴ The Final Rule includes a slightly trimmed version of the conflicts disclosure requirement, with two key requirements. Proxy advisors must provide prominent disclosure of:

- Any information regarding an interest, transaction, or relationship of the proxy voting advice business (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship;¹¹⁵ and
- Any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship.¹¹⁶

110. Final Rule, *supra* note 1, at 55,094 nn.158–160 (citing Institutional Shareholder Services, Inc., 1991 SEC No-Act. LEXIS 17 (Dec. 15, 1988), and Katherine H. Rabin, Chief Executive Officer, Glass, Lewis & Co., Statement to the U.S. House of Representatives Committee on Financial Services: Markup of H.R. 5983, the “Financial CHOICE Act of 2016,” at 3 (Sept. 13, 2016)).

111. *Id.* at 55,095.

112. *Id.*

113. *Id.*

114. The SEC described the virtues of a materiality-based approach in some detail in the Final Rule. The Commission noted, among other things, that “[t]he concept of materiality is at the core of our disclosure framework and has served our markets and investors well. Therefore, we believe that requiring proxy voting advice businesses to base their conflicts of interest disclosures on assessments of materiality is a more effective way to ensure that their clients have sufficient information to weigh the voting advice they are given.” *Id.* at 55,100.

115. Rule 14a-2(b)(9)(i)(A).

116. Rule 14a-2(b)(9)(i)(B).

The Final Rule differs from the Proposed Rule in that it is less prescriptive as to how the disclosures must be provided to clients. The Proposed Rule required proxy advisors to provide conflicts of interest disclosure “in its proxy voting advice *and* in any electronic medium used to deliver the advice” (emphasis added), but the Final Rule gives proxy advisors the option to include required disclosure “either in its proxy voting advice *or* in an electronic medium used to deliver the proxy voting advice, such as a client voting platform, which allows the business to segregate the information, as necessary, to limit access exclusively to the parties for which it is intended.”¹¹⁷ This flexibility should help reduce the costs of implementation, and thus “avoid imposing a significant new barrier to entry for the proxy voting advice business market.”¹¹⁸ This was one of the more significant concerns with creating an expanded regulatory structure for proxy advisors.

Ultimately, the SEC believes that enhanced conflicts disclosure will help clients better understand potential conflicts and how they may affect proxy advice. This, in turn, may lead to enhanced dialogue between proxy advisors and their clients on managing these potential conflicts, which could lead to better quality disclosures and procedures for mitigating conflicts. In addition, the SEC suggested that the ultimate investors may become more aware of conflicts, and “a dynamic regarding conflict disclosure among investors (those who ultimately bear the costs and benefits of voting), clients of proxy voting advice businesses, and proxy voting advice businesses, each of which have different incentives, may increase the benefits of the rule to the shareholder voting process more generally.”¹¹⁹

C. NOTICE OF PROXY ADVICE AND RESPONSE

The SEC’s most extensive modifications to its Proposed Rule in its Final Rule come on notice of proxy advice and response by registrants. After weighing the comments, the SEC adopted a more principles-based scheme than suggested in the Proposed Rule.

The Final Rule also clarifies that the notice and response rules were not driven solely by a concern over the rate of errors in proxy advice. As noted above, many commenters, including the proxy advisors themselves as well as a number of large institutional investors, suggested that the rules were unnecessary because there is not a high rate of errors in proxy advice. The SEC made clear that the proposed amendments “were not motivated solely by the Commission’s interest in the factual accuracy of proxy voting advice,” but were also driven by the SEC’s interest in and policy of “facilitating investor access to enhanced

117. Final Rule, *supra* note 1, at 55,101.

118. *Id.*

119. *Id.*

discussion of proxy voting matters contributes to more informed proxy voting decisions.”¹²⁰ “Ultimately,” the SEC affirmed, “we are guided by the principle that informed decision-making by shareholders is the foundation on which the legitimacy of the proxy voting system rests”¹²¹

The Final Rule acknowledges arguments by Glass Lewis and ISS for a more principles-based approach and provides considerably more flexibility in implementation than provided for in the Proposed Rule. The Final Rule thus only requires that, as a condition to the availability of the exemptions in Rules 14a-2(b)(1) and (b)(3), the proxy advisor adopt and disclose rules and procedures reasonably designed to ensure that:

- Registrants that are the subject of proxy voting advice have such advice made available to them at or prior to the time when such advice is disseminated to the proxy voting advice business’s clients,¹²² and
- The proxy voting advice business provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by registrants that are the subject of such advice, in a timely manner before the shareholder meeting (or, if no meeting, before the votes, consents, or authorizations may be used to effect the proposed action).¹²³

Note that this rule does not prescribe the manner in which notice is provided. Nor does it require that proxy advisors provide registrants with the opportunity to review proxy advice in advance of its delivery to voters—although the SEC notes that “providing registrants with the opportunity to review their proxy voting advice in advance would satisfy the principle and is encouraged to the extent feasible.”¹²⁴

The Final Rule under paragraph (iii) of Rule 14a-2(b)(9) provides a non-exclusive safe harbor to proxy advisors such that a proxy advisor “will be deemed to satisfy the requirement in paragraph (b)(9)(ii)(A) of this section if it has written policies and procedures that are reasonably designed to provide a registrant with a copy of its proxy voting advice, at no charge, no later than the time such advice is disseminated to the proxy voting advice business’s clients.”¹²⁵ The rules provide that such policies and procedures may include requirements, such as that the registrant had filed their definitive proxy statement at least 40 calendar

120. *Id.* at 55,107. The SEC further explains:

[T]he principle that more complete and robust information and discussion leads to more informed investor decision-making, and therefore results in choices more closely aligned with investors’ interests, has shaped our federal securities laws since their inception and is a principal factor in the Commission’s adoption of these amendments. Regardless of the incidence of errors in proxy voting advice, we believe it is appropriate to adopt reasonable measures designed to promote the reliability and completeness of information available to investors and those acting on their behalf at the time they make voting determinations.

Id.

121. *Id.*

122. Rule 14a-2(b)(9)(ii)(A).

123. Rule 14a-2(b)(9)(ii)(B).

124. Final Rule, *supra* note 1, at 55,109.

125. Rule 14a-2(b)(9)(iii).

days before the shareholder meeting, and that the registrant had expressly acknowledged that they will only use the proxy voting advice for their internal purposes and/or in connection with the solicitation and it will not be published or otherwise shared except with the registrant's employees or advisers.¹²⁶

The SEC intended its ultimate formulation of the rule—using a principles-based obligation (with a safe harbor to provide guidance)—to respond to concerns that its rules may affect the independence of proxy advisors,¹²⁷ increase the risk of insider trading, and impinge on proxy advisors' free speech rights.¹²⁸ The SEC also argued that the simpler, principles-based Final Rule should limit the “potential unintended consequences” of requiring a proxy advisor to engage and negotiate with a registrant prior to finalizing its advice, and reduce the risk of diminishing competition in the proxy advice industry. The comment process underscored the salience of these risks for the SEC, and it amended the rules accordingly. The SEC took pains to repeatedly¹²⁹ explain in the Final Rule that it is not a condition of the safe harbor or the principles-based requirement “that the proxy voting advice business negotiate or otherwise engage in a dialogue with the registrant, or revise its voting advice in response to any feedback . . . [and the proxy advisor] is free to interact with the registrant to whatever extent and in whatever manner it deems appropriate, provided it has a written policy that satisfies its obligations.”¹³⁰

Like the feedback and review requirement, the Proposed Rule's inclusion of registrants' responses to proxy advisors' adverse guidance met with significant resistance from many commenters, and the SEC amended the Proposed Rule substantially. The SEC adopted a similar principles-based approach by requiring that proxy advisors adopt and publicly disclose written policies and procedures reasonably designed to ensure that they provide clients with a mechanism by which they can reasonably be expected to become informed of a registrant's written statements about the proxy voting advice in a timely manner before the shareholder meeting. The notice rule similarly includes a non-exclusive safe harbor for proxy advisors. The safe harbor requires proxy advisors to (1) provide notice to its clients on its electronic platform, through email, or by other electronic means that the registrant intends to file or has filed additional soliciting materials and (2) include an active hyperlink to those materials on EDGAR when available.

126. Rule 14a-2(b)(9)(iii)(A)-(B).

127. The SEC noted:

[B]ecause Rule 14a-2(b)(9)(ii) does not require proxy voting advice businesses to adopt policies that would provide registrants with the opportunity to review and provide feedback on their proxy voting advice before such advice is disseminated to clients, the rule does not create the risk that such advice would be delayed or that the independence thereof would be tainted as a result of a registrant's pre-dissemination involvement.

Final Rule, *supra* note 1, at 55,112.

128. The SEC included an entire section addressing constitutional objections. See *Id.* at 55,117–55,118. The changes to the review and feedback requirement, the amendment to the hyperlink requirement, and the exception for custom policies responded to these First Amendment concerns.

129. The SEC noted the lack of a review and feedback requirement at least 6 times in the section on Notice to Registrants and Safe Harbor. See *Id.* at 55,109–55,112.

130. *Id.* at 55,112.

The move to a principles-based approach likewise led the SEC to remove the provision from the Proposed Rule that would have excused immaterial or unintentional failures to comply with the notice and feedback provisions of Proposed Rule 14a-2(b)(9). The provision was motivated, the SEC noted, “by our recognition of a potentially significant adverse result for a proxy voting advice business if it were to lose the ability to rely on the exemptions set forth in Rules 14a-2(b)(1) or (b)(3).”¹³¹ In light of the Final Rule’s principles-based approach, the SEC no longer viewed the provisions as necessary.

Finally, the SEC recognized that the requirements of Rule 14a-2(b)(9)(ii) are not necessary for every kind of proxy advice. Thus, Rule 14a-2(b)(9)(v) states that Rule 14a-2(b)(9)(ii) does not apply to proxy advice that is based on custom voting policies that are proprietary to a proxy voting advice business’s client.¹³² Likewise, Rule 14a-2(b)(9)(ii) does not apply to proxy advice that makes a recommendation to a security holder as to its vote, consent, or authorization in a solicitation to approve certain mergers and acquisitions or contested matters.¹³³ The SEC noted that such communications still constitute “solicitations” within the meaning of Rule 14a-9, however.

D. AMENDMENTS TO THE ANTIFRAUD RULE 14A-9

The SEC made one additional change to the Final Rule based on comments. As noted above, under the Proposed Rule the Note to Rule 14a-9 included a new paragraph (e) stating that the failure to disclose material information “such as the proxy voting advice business’s methodology, sources of information, conflicts of interest or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves” could, depending on the facts and circumstances, be misleading within the meaning of 14a-9. The Final Rule, however, eliminates the reference to “use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.”¹³⁴

131. *Id.* at 55,114.

132. Rule 14a-2(b)(9)(v). The SEC noted “commenters’ concerns regarding the potential costs that would be imposed upon investors, as well as their doubts regarding the corresponding investor protection-based benefits, if the requirements of Rule 14a-2(b)(9)(ii) were to be applied to proxy voting advice based on a custom policy.” Final Rule, *supra* note 1, at 55,115. The SEC also recognized that proxy advisors typically use the same data to produce proxy advice, whether it is for specialty, benchmark, or custom policies, and in any case clients with custom policies also receive reports containing advice based on benchmark policies. “Thus,” the Final Rule explains, “because the proxy voting advice based on the benchmark policies—including the data, research, and analysis therein—would be subject to Rule 14a-2(b)(9)(ii), clients that receive proxy voting advice pursuant to their custom policies generally will benefit from an awareness of any responses that the registrants may file thereto.” *Id.* at 55,115–55,116.

133. Rule 14a-2(b)(9)(vi). Such transactions are “generally fast-moving and can be subject to frequent changes and short time windows. . . [resulting in proxy advisors] having to deliver their advice to clients on a tighter deadline, and with less lead time before the applicable meeting, than they would under normal circumstances.” Final Rule, *supra* note 1, at 55,116 n.399. The SEC clarified, however, that this exception applies only to the portions of the proxy advice “relating to the applicable M&A transaction or contested matters and not to proxy voting advice regarding other matters presented at the relevant meeting.” *Id.* at 55,116.

134. Final Rule, *supra* note 1, at 55,119.

The Final Rule reiterates the SEC’s view that the additional example in new paragraph (e) does not broaden the concept of materiality, nor does it create a new cause of action. The examples included in the Note are “illustrative only, and are not intended to be exhaustive or absolute, or supersede the materiality principle or the facts and circumstances analysis required in each particular case.”¹³⁵ However, the SEC recognized the concern of some commenters that the clause on the use of standards that may differ from SEC standards “may increase legal uncertainty and litigation risks to both proxy voting advice businesses and registrants, and that the lack of legal certainty could affect the quality of analyses provided by proxy voting advice businesses.”¹³⁶ Notwithstanding the removal of the clause, the SEC asserted in the Final Rule that “there could well be occasions where, for example, the omission or distortion of essential context from a proxy voting advice business’s explanation of its methodologies may be misleading under a materiality principle and the particular facts and circumstances, such that a shareholder’s ability to make an informed voting decision is subverted.”¹³⁷

E. GUIDANCE TO INVESTMENT ADVISERS

In addition to the Final Rule, the SEC produced guidance for investment advisers “in light of information gained in connection with our ongoing review of the proxy voting process and our related regulations, including the amendments to the proxy solicitation rules under the Exchange Act.”¹³⁸ Written in a question-and-response format, the guidance focuses in particular on automated voting by investment advisers, also known as “robo-voting.”¹³⁹ Specifically, the guidance notes that many investment advisers use automated voting procedures. However, if a registrant has filed a response to a proxy advisor’s adverse recommendation, how should an investment advisor using automated voting make sure it is considering such information in making voting determinations in a client’s best interest?

The SEC’s response notes that if an issuer files a response “sufficiently in advance of the submission deadline and such information would reasonably be expected to affect” an investment adviser’s voting decision, the investment adviser would “likely need to consider such information prior to exercising voting authority in order to demonstrate that it is voting in its client’s best interest.” Reiterating prior guidance, the SEC reminded advisers they must provide disclosure of an advisory relationship with a proxy advisor that is full, fair, and “sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision whether to provide consent.”¹⁴⁰

135. *Id.* at 55,121.

136. *Id.*

137. *Id.*

138. Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 85 Fed. Reg. 55,155 (Sept. 3, 2020) (Release No. IA-5547, dated July 22, 2020) [hereinafter “Guidance Supplement”], <https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16338.pdf>.

139. For a detailed discussion of the practice, see DOYLE, *supra* note 16. See also Paul Rose, *Robovoting and Proxy Vote Disclosure*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Nov. 25, 2019), <https://corpgov.law.harvard.edu/2019/11/25/robovoting-and-proxy-vote-disclosure/>.

140. Guidance Supplement, *supra* note 138, at 55,155 (citing 2019 SEC Interpretation, *supra* note 23, at 33,675).

Specifically, advisers using automated voting should disclose the extent to which they are using automated voting, the circumstances of that use, and how their policies and procedures address the use of automated voting in cases in which the adviser may become aware that a registrant intends to file or has filed additional soliciting materials before the submission deadline for proxies to be voted at the shareholder meeting.¹⁴¹ Investment advisers should also consider whether their policies and procedures are “reasonably designed to address these disclosures.”¹⁴² With full, fair, and specific disclosures by investment advisers, clients will more likely have the information they need to provide informed consent with respect to the automated voting either (a) “for purposes of agreeing to the scope of the relationship,” or (b) “as it relates to the investment adviser’s obligation, under its duty of loyalty, to provide full and fair disclosure relating to the advisory relationship.”¹⁴³

FIVE

POTENTIAL LEGAL CHALLENGES TO THE FINAL RULE

The Administrative Procedure Act (APA) establishes the default standards for judicial review of rulemaking and other agency action.¹⁴⁴ The APA judicial review standards apply when Congress has made a particular agency action “reviewable by statute” and the action is “final agency action for which there is no other adequate remedy in a court.”¹⁴⁵ The SEC’s Final Rule here, if challenged in court, will be subject to the judicial reviews provisions of the APA and related administrative law doctrines.¹⁴⁶

141. *Id.*

142. *Id.* at 55,156.

143. *Id.*

144. Administrative Procedure Act, 5 U.S.C. § 101 *et seq.*

145. *Id.* § 704.

146. 15 U.S.C. § 78y (providing for judicial review of orders and rules).

Here there seem to be three sets of potential challenges to the Final Rule: (A) the traditional arbitrary-and-capricious challenge under the APA; (B) a challenge under the logical outgrowth doctrine for the substantive differences between the Proposed Rule and the Final Rule; and (C) a challenge to the SEC’s statutory interpretation of “solicitation” to encompass proxy advice services. In this Part, each is addressed in turn.

A. APA ARBITRARY-AND-CAPRICIOUS CHALLENGES

Under the APA, the reviewing court must set aside an agency action that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”¹⁴⁷ This requirement has been interpreted as a reasoned decisionmaking requirement.¹⁴⁸ In *Motor Vehicle Manufacturers Ass’n v. State Farm Mutual Automobile Insurance Co.*, the Supreme Court explained that “[t]he scope of review under the ‘arbitrary and capricious’ standard is narrow and a court is not to substitute its judgment for that of the agency.”¹⁴⁹ But “the agency must examine the relevant data and articulate a satisfactory explanation for its action”:

[A]n agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.¹⁵⁰

In other words, the inquiry is whether the agency addressed and considered the factors set forth by Congress in the agency’s organic statute; whether the agency considered all important aspects of the problem it was seeking to address through regulatory action; whether its proposed action is consistent with the evidence gathered; and whether the action otherwise demonstrates reasoned decisionmaking as evidenced by the quality and coherence of the agency’s reasoning. Under the APA, the Supreme Court has emphasized that “[a]n agency must consider and respond to significant comments received during the period for public comment.”¹⁵¹ That is because this APA-guaranteed “opportunity to comment is meaningless unless the agency responds to significant points raised by the public.”¹⁵²

147. 5 U.S.C. § 706(2)(A). The APA also requires a court to set aside agency action when it is contrary to the Constitution or exceeds the agency’s statutory authority. See *id.* § 706(2)(B), (2)(C).

148. See generally 1 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE §7.4, at 599–600 (5th ed. 2010) (explaining that the Supreme Court’s “hard look” doctrine requires agencies to discuss all major issues it considered in formulating a major rule to demonstrate that its rule meets the APA’s reasoned decision-making requirement).

149. 463 U.S. 29, 43 (1983).

150. *Id.*

151. *Perez v. Mortgage Bankers Ass’n*, 135 S. Ct. 1199, 1203 (2015) (citing *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971)).

152. *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35–36 (D.C. Cir. 1977) (per curiam) (footnote omitted).

Two recent Supreme Court decisions break some new ground on how courts should review agency actions under the APA’s arbitrary-and-capricious standard. In *Department of Commerce v. New York* (the census citizenship question case), the Court made two substantial moves. First, the Court, citing *Baltimore Gas & Electric Co. v. NRDC*, emphasized “the choice between reasonable policy alternatives in the face of uncertainty was the Secretary’s to make” and the importance of “[w]eighing that uncertainty against the value of obtaining more complete and accurate citizenship data.”¹⁵³ Jacob Gersen and Adrian Vermeule have coined this *Baltimore Gas* standard as thin-rationality review:

Baltimore Gas made clear (1) that it is generally sufficient that an agency states the nature of its uncertainty—not that it resolve it; (2) that agencies are entitled to adopt any rational assumptions to cope with uncertainty, including highly optimistic assumptions, which are just as rational as highly pessimistic ones; and (3) that courts may not demand the impossible by requiring agencies to explain why they have chosen the assumptions they have, as opposed to other assumptions.¹⁵⁴

Second, and conversely, the Court in the census case held that under the APA’s “reasoned explanation requirement,” an agency must “offer genuine justifications for important decisions, reasons that can be scrutinized by courts and the interested public.”¹⁵⁵ In other words, reasons that are pretextual are not sufficient.

Last Term, in *Department of Homeland Security v. Regents of University of California* (the DACA immigration relief rescission case), the Supreme Court held that arbitrary-and-capricious review under the APA requires the agency to consider reasonable regulatory alternatives and to demonstrate that it has adequately considered the reliance interests at stake in changing the regulatory baseline.¹⁵⁶ This decision is reminiscent of the D.C. Circuit’s approach to reviewing financial regulation under the APA, discussed next.

In a trilogy of cases concerning cost-benefit analysis in financial regulation at the SEC, the D.C. Circuit has articulated a number of principles it perceives as required by APA arbitrary-and-capricious review and the SEC’s organic statute.¹⁵⁷ As we detail elsewhere, in those cases the D.C. Circuit identified several grounds for setting aside an agency’s rule under the APA:

- Failure to consider certain costs—quantitatively or qualitatively—based on the rationale that the costs are difficult to quantify (*Chamber of Commerce*);
- Failure to provide a reasoned basis for rejecting a nonfrivolous alternative to the proposed rule (*Chamber of Commerce*);

153. 139 S. Ct. 2551, 2569–71 (2019) (citing *Baltimore Gas & Elec. Co. v. NRDC*, 462 U.S. 87, 105 (1983)); see also *id.* at 2571 (“By second-guessing the Secretary’s weighing of risks and benefits and penalizing him for departing from the Bureau’s inferences and assumptions, Justice BREYER—like the District Court—substitutes his judgment for that of the agency.”).

154. Jacob Gersen & Adrian Vermeule, *Thin Rationality Review*, 114 MICH. L. REV. 1355, 1406 (2016).

155. *Dep’t of Commerce*, 139 S. Ct. at 2575–76.

156. *DHS v. Regents of Univ. of Cal.*, 140 S. Ct. 1891, 1911–13 (2020).

157. See *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

- Failure to provide a reasoned basis for the agency’s consideration of a factor set forth by Congress in the agency’s organic statute (*American Equity Investment*);
- Failure to attempt to define the baseline as a comparison to the proposed rule as well as its alternatives (*American Equity Investment*); and
- Failure to take into account the benefits of the status quo yet take into account the costs of the status quo (*Business Roundtable*).¹⁵⁸

These principles from the Supreme Court and D.C. Circuit establish the framework within which the reviewing court would assess the SEC’s proxy advisor rule under the APA.

As others have documented, the SEC seems to have substantially improved the economic analysis in its rulemaking since the D.C. Circuit’s trilogy of cases.¹⁵⁹ The Final Rule here appears to be yet another example of improved economic analysis and reasoned decisionmaking more generally. As detailed in Parts II, III, and IV, the SEC engaged in a deliberative process to ensure it considered a variety of regulatory alternatives¹⁶⁰ against a well-defined baseline,¹⁶¹ as well as considered the various intended and unintended costs, benefits, and other effects.¹⁶² The SEC expressly considered reliance interests implicated,¹⁶³ was careful to note when and why it could not quantify certain benefits or costs,¹⁶⁴ and exhaustively analyzed how the Final Rule would promote the values outlined in the SEC’s governing statute of efficiency, competition, and capital formation.¹⁶⁵

158. See Paul Rose & Christopher J. Walker, *The Importance Of Cost-benefit Analysis In Financial Regulation* 28–34 (Report for U.S. Chamber of Commerce, March 2013), <https://ssrn.com/abstract=2231314>.

159. See, e.g., Jerry Ellig, *Improvements in SEC Economic Analysis after Business Roundtable: A Structured Assessment*, 19 FLA. ST. U. BUS. REV. 51 (2020); Joshua T. White, *The Evolving Role of Economic Analysis in SEC Rulemaking*, 50 GA. L. REV. 293 (2015); see also Rose & Walker, *supra* note 157/158, at 34–36 (detailing how the SEC initially responded to *Business Roundtable* to improve its economic analysis in rulemaking).

160. Final Rule, *supra* note 1, at 55,143–55,145 (analyzing seven main regulatory alternatives).

161. *Id.* at 55,126–55,133 (extensively detailing economic baseline).

162. *Id.* at 55,132–55,140 (analyzing the costs and benefits of each component of the Final Rule and responding to comments).

163. See, e.g., *id.* at 55,107 (“The Commission is aware of the risk that introducing new rules into a complex system like proxy voting, which has evolved over many years in response to changes in the marketplace as well as the interests and needs of market participants, could inadvertently disrupt the system and impose unnecessary costs if not carefully calibrated. For example, we understand the timing pressures and logistical challenges faced by shareholders, investment advisers, registrants, and, as a result, proxy voting advice businesses and their clients, particularly during the peak of proxy season. We also acknowledge the concerns expressed by a number of commenters that the adoption of an overly prescriptive framework governing aspects of the proxy voting advice system could, depending on various facts and circumstances, impede the ability of proxy voting advice businesses to provide their clients with timely voting advice. Ultimately, we are guided by the principle that informed decision-making by shareholders is the foundation on which the legitimacy of the proxy voting system rests and believe that a well-functioning proxy system benefits from the ability of clients of proxy voting advice businesses to obtain more complete information on which to base their voting decisions.” (footnotes omitted)).

164. See *id.* at 55,132–55,140.

165. *Id.* at 55,140–55,144.

And, as discussed in Parts III and IV, the SEC carefully addressed the various comments and criticisms raised during the comment period. Indeed, as outlined in Part IV, the SEC ultimately adopted “a less prescriptive, more principles-based manner” for regulating proxy advice than initially suggested in the Proposed Rule.¹⁶⁶ The SEC did so “in response to comments received to provide appropriate flexibility to proxy voting advice businesses to meet the principles that underlie the objectives of the rule, and to avoid unnecessary potential disruptions to their ability to provide their clients with timely voting advice.”¹⁶⁷ These changes were also made to “address[] the concerns raised by commenters regarding the potential unintended consequences of requiring a proxy voting advice business to engage with a registrant in connection with its proxy voting advice, including those related to timing and the risk of affecting the independence of the advice or diminishing competition in the proxy voting advice business industry.”¹⁶⁸

Especially in light of the SEC’s decision to narrow the regulatory reach on proxy advisors in the Final Rule, it is difficult to see how proxy advisors (or proponents of the Proposed Rule, for that matter) could mount a successful legal challenge to the Final Rule under the APA’s arbitrary-and-capricious standard. After all, as the Supreme Court recently reiterated, the scope of arbitrary-and-capricious review is “narrow”: the reviewing court “may not substitute [its] judgment for that of the [agency], but instead must confine [itself] to ensuring that [the agency] remained “within the bounds of reasoned decisionmaking.”¹⁶⁹ The court must “determine only whether the [agency] examined ‘the relevant data’ and articulated ‘a satisfactory explanation’ for [its] decision, ‘including a rational connection between the facts found and the choice made.’”¹⁷⁰ In so doing, the court should not “second-guess[] the [agency’s] weighing of risks and benefits,” as “the choice between reasonable policy alternatives in the face of uncertainty was the [agency’s] to make.”¹⁷¹

Here, the SEC seems to have effectively and deliberately engaged in such reasoned decisionmaking as required by the Supreme Court and the D.C. Circuit under the APA’s arbitrary-and-capricious standard of review.

166. *Id.* at 55,107.

167. *Id.* at 55,084; see also *id.* at 55,137 (“We recognize the concerns raised by these commenters regarding compliance costs associated with the proposed registrant review and response process. In response, as suggested by several commenters, we are adopting a more principles-based approach intended to achieve many of the same objectives of the proposal without unduly encumbering the ability of proxy voting advice businesses to provide their clients with timely and reliable voting advice.”).

168. *Id.* at 55,112 (footnotes omitted).

169. *Dep’t of Commerce v. New York*, 139 S. Ct. 2551, 2569 (2019) (quoting *Baltimore Gas & Elec. Co. v. NRDC*, 462 U.S. 87, 105 (1983)).

170. *Id.* (quoting *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted)).

171. *Id.* at 2569–71.

B. LOGICAL OUTGROWTH DOCTRINE CHALLENGE

When an agency engages in notice-and-comment rulemaking, the APA requires the agency to publish a “[g]eneral notice” as well as the “terms or substance of the proposed rule or a description of the subjects and issues involved.”¹⁷² Just as courts have required agencies to respond to significant comments,¹⁷³ they have required that agencies provide adequate notice of the anticipated regulatory action in the proposed rule and that the final rule be a “logical outgrowth” of the proposed rule.¹⁷⁴ In other words, as the D.C. Circuit has framed the doctrine, “Where the change between proposed and final rule is important, the question for the court is whether the final rule is a ‘logical outgrowth’ of the rulemaking proceeding.”¹⁷⁵ And “the logical outgrowth test normally is applied to consider whether a new round of notice and comment would provide the first opportunity for interested parties to offer comments that could persuade the agency to modify its rule.”¹⁷⁶

The Supreme Court has explained that, under the logical outgrowth doctrine, “[t]he object, in short, is one of fair notice.”¹⁷⁷ In applying the logical outgrowth doctrine, the D.C. Circuit has held that it is permissible for an agency to adopt a less-stringent regulatory option if “the rulemaking produced enough evidence” and if the proposed rule “adequately anticipated the” final rule.¹⁷⁸ The D.C. Circuit has explained that the standard is not whether “the agency might have given clearer notice of the potential change from the proposed rule,” or whether “fuller notice might have added something to the record.”¹⁷⁹ Instead, the court adopted a “harmless error” rule, quoting at length the First Circuit’s approach:

Not only do we think that petitioners had fair notice . . . , but we cannot think how their comments would have differed fundamentally if they had known what EPA would do. Though they would have had a different proposition against which to argue, their proposed solutions would, presumably, have been the same for the same reasons. They might have responded in greater volume or more vociferously, but they have not shown us that the content of their criticisms would have been different to the point that they would have stood a better chance of convincing the Agency¹⁸⁰

172. 5 U.S.C. § 553(b).

173. See, e.g., *Perez v. Mortgage Bankers Ass’n*, 135 S. Ct. 1199, 1203 (2015); *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35–36 (D.C. Cir. 1977) (per curiam).

174. See, e.g., *National Black Media Coalition v. FCC*, 791 F.2d 1016, 1022 (2nd Cir. 1986); *United Steelworkers of America, AFL-CIO-CLC v. Marshall*, 647 F.2d 1189, 1221 (D.C. Cir. 1980); *South Terminal Corp. v. EPA*, 504 F.2d 646, 659 (1st Cir. 1974).

175. *Marshall*, 647 F.2d at 1221.

176. *Nat’l Exch. Carrier Ass’n, Inc. v. FCC*, 253 F.3d 1, 4 (D.C. Cir. 2001) (quoting *Arizona Public Service Co. v. EPA*, 211 F.3d 1280, 1299 (D.C. Cir. 2000)).

177. *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 174 (2007).

178. *Marshall*, 647 F.2d at 1222–23.

179. *Id.* at 1225.

180. *Id.* (quoting *BASF Wyandotte Corp. v. Costle*, 598 F.2d 637, 642 (1st Cir. 1979)).

Indeed, the D.C. Circuit has more recently explained that “our cases finding that a rule was not a logical outgrowth have often involved situations where the proposed rule gave no indication that the agency was considering a different approach, and the final rule revealed that the agency had completely changed its position.”¹⁸¹

Here, the SEC made some relatively major changes from the Proposed Rule to the Final Rule. As discussed in Part IV, the Final Rule embraced a more “principles-based” approach than the Proposed Rule that provides greater flexibility for proxy advisors compliance and removed the provisions in the Proposed Rule that would have given companies the opportunity to review and comment on proxy advice before it was sent to investor clients. All of the significant changes from the Proposed Rule to the Final Rule were made in response to concerns raised by proxy advisors and their supporters—to lessen the regulatory burden and address the costs and unintended consequences raised during the public comment period.

Accordingly, arguments that the Final Rule flunks the logical outgrowth test are unavailing. The public had fair notice that the agency may not adopt all of the regulatory actions set forth in the Proposed Rule.¹⁸² Another round of notice-and-comment rulemaking would not be the first opportunity for proxy advisors to raise arguments against the SEC’s approach on the Final Rule.¹⁸³ Indeed, it would be curious for the proxy advisors to argue against the changes in the Final Rule when the changes occurred to accommodate their concerns.

181. CSX Transp., Inc. v. Surface Transp. Bd., 584 F.3d 1076, 1081 (D.C. Cir. 2009).

182. See, e.g., Ass’n of Am. Railroads v. Dep’t of Transp., 38 F.3d 582, 589 (D.C. Cir. 1994) (rejecting a logical outgrowth challenge where the agency’s final rule constituted “only partial adoption of the proposed comprehensive rule”).

183. One set of commenters, in arguing that the SEC’s economic analysis was flawed in the Proposed Rule, advocated that “it would be an arbitrary and indefensible process failure for the SEC to propose a rule, include fundamentally lacking economic analysis in the release, and then, having that lack pointed out to the SEC, fail to republish the proposal with the analysis included, but instead proceed to adopt a rule, even if better or more compliant economic analysis is included in the final rule release.” Comments from John C. Coates IV & Barbara Roper, at 2 (Jan. 30, 2020), <https://www.sec.gov/comments/s7-22-19/s72219-6729671-207390.pdf>. Here, the SEC responded to various comments on its economic analysis in the Final Rule. Providing additional economic analysis and other reasons for regulation in the Final Rule does not violate the logical outgrowth doctrine, which concerns regulatory actions, not rationales. Nor is it at all unusual for agencies to improve their reasoning in the final rule in response to comments lodged during the notice-and-comment rulemaking process. To interpret the APA to require an agency to redo the rulemaking anew in such circumstances would be a dramatic, anti-administrativist development. To be sure, we do not read the commenters as suggesting that such a requirement exists in the APA, much less that courts can require that. Cf. John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 889 (2015) (arguing against a judicially enforced quantification of cost-benefit analysis in financial regulation).

C. CHALLENGE TO THE SEC'S STATUTORY DEFINITION OF "SOLICITATION"

When reviewing an agency's statutory interpretation that is promulgated through notice-and-comment rulemaking, federal courts apply the familiar *Chevron* two-step deference doctrine.¹⁸⁴ At step one, the reviewing court must assess whether the statutory provision at issue is ambiguous. If so, the court proceeds to step two to determine whether the agency's position is a reasonable interpretation of the statute.¹⁸⁵

In October 2019, ISS filed a lawsuit to challenge the SEC's interpretive release that defined "solicitation" under the Exchange Act to apply to proxy guidance.¹⁸⁶ ISS challenged this agency guidance document on two grounds. First, it challenged the process (i.e., agency guidance document) for promulgating the agency's statutory interpretation—a challenge mooted by the codification of the interpretation in the Final Rule. Second, ISS challenged the substance of the SEC's statutory interpretation: "The text, purpose, history, and structure of the Exchange Act and Advisers Act all confirm that proxy advice and proxy solicitation are fundamentally distinct activities that are regulated in different ways. The SEC lacks authority to regulate proxy advice as though it were a solicitation, and its holding otherwise in the Proxy Adviser Release is contrary to law."¹⁸⁷ The SEC and ISS agreed to stay the litigation and the SEC's enforcement of this statutory definition until after issuance of the Final Rule.¹⁸⁸

Section 14(a) of the Exchange Act makes it "unlawful for any person . . . in contravention of such rules and regulations as the Commission may prescribe . . . to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security . . ."¹⁸⁹ There is no dispute that Congress has charged the SEC to promulgate regulations "as necessary or appropriate in the public interest or for the protection of investors" to implement Section 14(a).¹⁹⁰ The Supreme Court has held that Section 14(a) has "broad remedial purposes," including "to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation."¹⁹¹

184. *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 844 (1984); see also *United States v. O'Hagan*, 521 U.S. 642, 673 (1997) (applying the *Chevron* deference framework to an SEC's statutory interpretation promulgated via rulemaking "[b]ecause Congress has authorized the Commission, in § 14(e) [of the Securities and Exchange Act of 1934], to prescribe legislative rules").

185. See generally Kent Barnett & Christopher J. Walker, *Chevron in the Circuit Courts*, 116 MICH. L. REV. 1 (2017).

186. Complaint, *Institutional Shareholder Services, Inc. v. SEC*, No. 19-cv-03275 (filed Oct. 31, 2019, D.D.C.) [hereinafter "ISS Complaint"], <https://www.issgovernance.com/file/duediligence/iss-oct-31-2019-complaint.pdf>; see also Steven Friedman, *The Basis for ISS' Lawsuit Against the SEC*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Nov. 5, 2019), <https://corpgov.law.harvard.edu/2019/11/05/the-basis-for-iss-lawsuit-against-the-sec/>.

187. ISS Complaint, *supra* note 186, ¶ 4.

188. See Andrea Vittorio, *Proxy Firm ISS Agrees to Wait for Final Rule in Suit Against SEC*, BLOOMBERG LAW (Jan. 17, 2020).

189. 15 U.S.C. § 78n(a).

190. *Id.* § 78n(a)(2) (specific statutory grant of authority to the SEC to prescribe rules and regulations concerning solicitation of proxies); see also *id.* § 78w (general statutory grant of rulemaking authority to the SEC).

191. *J. I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964).

Accordingly, the SEC had authority to engage in this rulemaking, and thus a reviewing court will review the SEC's statutory interpretation under the *Chevron* deference framework.¹⁹²

Turning to *Chevron*'s first step, Congress did not define the term "solicit" in the Exchange Act.¹⁹³ In light of this congressional silence, many courts would thus proceed to *Chevron*'s second step to determine whether the agency's interpretation is reasonable¹⁹⁴—a step at which one study has found that agencies win nearly 95% of the time in the federal courts of appeals.¹⁹⁵ If the reviewing court reaches step two here, it is difficult to see how challengers could prevail in convincing the court that the SEC's definition of solicitation is unreasonable.

As detailed in the Final Rule, the SEC defined solicitation in 1935 and over the years has amended that definition "as needed to respond to new and changing market practices that have raised the concerns underlying Section 14(a)."¹⁹⁶ In 1956, the SEC updated the definition to encompass more than proxy requests but also any "communication to security holders under circumstances reasonably calculated to result in the procurement, execution, or revocation of a proxy."¹⁹⁷ The SEC expanded the statutory definition because "some market participants were distributing written communications designed to affect shareholders' voting decisions well in advance of any formal request for a proxy that would have triggered the filing and information requirements of the federal proxy rules."¹⁹⁸ In its 2019 interpretive release and then in the Final Rule, the SEC explained that, under the 1956 definition, "proxy voting advice businesses generally engage in solicitations when they provide proxy voting advice to their clients."¹⁹⁹

192. See, e.g., *City of Arlington, Tex. v. FCC*, 569 U.S. 290, 307 (2013) ("[T]he preconditions to deference under *Chevron* are satisfied because Congress has unambiguously vested the FCC with general authority to administer the Communications Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority.").

193. ISS Complaint, *supra* note 186, ¶ 14 (conceding that "solicit" is not defined in the statute). In its complaint, ISS did not raise a nondelegation doctrine challenge regarding Congress's decision to leave "solicit" undefined and broad. So we do not address that potential challenge at length here. Under existing precedent, such nondelegation challenge would not fare well. See, e.g., *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 474 (2001) (per Scalia, J.) ("In the history of the Court we have found the requisite 'intelligible principle' lacking in only two statutes, one of which provided literally no guidance for the exercise of discretion, and the other of which conferred authority to regulate the entire economy on the basis of no more precise a standard than stimulating the economy by assuring 'fair competition.'"). Recently, however, a number of Justices have expressed interest in reinvigorating the nondelegation doctrine. See *Gundy v. United States*, 139 S. Ct. 2116, 2148 (2019) (Gorsuch, J., dissenting); *Id.* at 2131 (Alito, J., concurring in the judgment); *Paul v. United States*, 140 S. Ct. 342, 342 (2019) (statement of Kavanaugh, J.). See generally Jonathan H. Adler & Christopher J. Walker, *Delegation and Time*, 105 IOWA L. REV. 1931, 1932–36 (2020).

194. See, e.g., *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842–43 (1984) ("If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." (footnote omitted)).

195. Barnett & Walker, *supra* note 185, at 32 & fig.2.

196. Final Rule, *supra* note 1, at 55,087–55,088.

197. *Id.* (citing Adoption of Amendments to Proxy Rules, 21 Fed. Reg. 577 (Jan. 26, 1956)).

198. *Id.*

199. *Id.* at 55,088.

Based on a number of factors, the SEC concluded that proxy voting advice is “a communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.”²⁰⁰ This seems like a reasonable interpretation, especially in light of the broad remedial purposes of Section 14(a) and the decades of agency and judicial precedent that similarly interpret this term.²⁰¹

It is thus no surprise that ISS, in its complaint challenging the SEC’s statutory interpretation, argued that while the term solicit is left undefined in the statute, the statutory terms “solicit any proxy” are unambiguous. ISS argued that “solicit any proxy” can *only* mean “to seek to obtain a proxy or encourage a shareholder to vote a certain way in order to *achieve a certain outcome* in a shareholder vote.”²⁰² Under that definition, ISS argued, proxy voting advice does not fit, as a proxy advisor is not seeking to achieve a certain outcome.

If writing on a blank slate and interpreting the statutory text without regard to decades of judicial and agency precedent, some may well conclude that the best interpretation of “solicit any proxy” should be limited in this or similar fashion. But it is a stretch to conclude that this is the *only* plausible interpretation, as required for an agency to lose at *Chevron*’s first step. After all, to embrace this interpretation, ISS must add the narrowing language—“in order to *achieve a certain outcome* in a shareholder vote”—it wants to be included in the statutory text. That’s not how judicial review works under *Chevron*.²⁰³ As the Supreme Court has explained, “If a statute is ambiguous, and if the implementing agency’s construction is reasonable, *Chevron* requires a federal court to accept the agency’s construction of the statute, even if the agency’s reading differs from what the court believes is the best statutory interpretation.”²⁰⁴

Because Congress did not define “solicit” in Section 14(a) of the Exchange Act but instead charged the SEC with promulgating rules and regulations to develop a definition “as necessary or appropriate in the public interest or for the protection of investors,” it is difficult argue that the agency should lose at *Chevron*’s first step. In light of the decades of agency and judicial precedent interpreting and implementing Section 14(a) and the policy purposes behind Section 14(a), it is even more difficult to argue that the SEC’s approach to solicitation in the Final Rule is unreasonable.

200. *Id.* at 55,089.

201. Those judicial and agency precedents are further discussed in Parts II.A and IV.A.

202. ISS Complaint, *supra* note 186, ¶ 15 (emphasis in original).

203. In recent years, there has been growing call to eliminate *Chevron* deference. See Christopher J. Walker, *Attacking Auer and Chevron Deference: A Literature Review*, 16 GEO. J.L. & PUB. POL’Y 103 (2018). The Supreme Court refusal’s to overrule *Auer* deference to agency regulatory interpretations, however, likely means it will not be revisiting *Chevron* deference anytime soon. See *Kisor v. Wilkie*, 139 S. Ct. 2400, 2408 (2019).

204. *Nat’l Cable & Telecommunications Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005); see also *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843 n.11 (1984) (“The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.”).

CONCLUSION

The SEC's Final Rule to regulate the proxy advisor industry is unlikely to be the final word on the subject. After all, the Proposed Rule had sought to impose even more regulatory oversight on the industry, in response to extensive criticisms about accuracy, transparency, and fairness. Yet, in the Final Rule, the SEC listened to concerns raised by the proxy advisors and their supporters and adopted a more flexible, principles-based framework that results in less regulatory oversight. As a policy matter, we believe the SEC made an important step in the right direction to address issues in the proxy advisor industry. But strong critics of the proxy advisor industry will no doubt press for further regulatory oversight.

From a litigation perspective, moreover, the SEC's decision to retreat from the Proposed Rule and embrace a more flexible regulatory approach makes it much harder for the proxy advisory industry to challenge the Final Rule under the Administrative Procedure Act and related administrative law doctrines. The SEC here appears to have engaged in a very deliberative, reasoned-decisionmaking process. And arguments that the SEC exceeded its statutory authority seem unavailing and contrary to decades of judicial and agency precedent.



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