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In Praise of Process: Examining the SEC, Rule 14a-8(i)(8), and *AFSCME v. AIG*

INTRODUCTION

SINCE THE FALL OF 2008, WHEN THE FINANCIAL CRISIS HIT THE U.S. economy like an unheralded tsunami, people from many different sectors have been casting about looking for answers. The questions are legion: How did we not see it? What do we do now? And, most importantly, what caused this to happen?

It would be arrogant and presumptuous for any one person to assume that they have found the answer to that last question (although that has not stopped many from trying). Nonetheless, an examination of individual threads is an important part of the process, if for no other reason than to begin discovering immediate ramifications of the crisis and to demonstrate the interrelated threads that run across the whole web of causes.

Rule 14a-8(i)(8) is one such thread.¹

Rule 14a-8(i)(8) is a provision under Exchange Act Rule 14a-8—which is commonly known as the proxy access rule.² Specifically, Rule 14a-8(i)(8), is the “election exclusion” to the proxy access rule.

One of the perceived causes of the financial crisis is that there was not enough oversight and accountability of corporate officers and directors.³ Some advocates

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1. The rule is found under the Securities Exchange Act of 1934. Shareholder Proposals, 17 C.F.R. § 240.14a-8(i)(8)(2009).

2. Proxy access rules all relate to issues surrounding corporate elections. In the realm of corporate elections, proxy statements are the “ballots” that companies use to move through their initiatives. See 17 C.F.R. § 240.14a-8.

3. See Risk Metrics Group, *Risk Metrics Group: 2008 Post Season Report*, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 2009, at 89, 138 (PLI Corporate Law & Practice, Course Handbook Series No. 18393, 2009) (noting that the perceived reason for the current crisis was a lack of regulatory oversight and corporate governance).

posited that increased shareholder access to corporate ballots and, by extension, corporate boardrooms would help serve as a check against officers and directors who would take increasingly riskier ventures with corporate funds.⁴

The Securities and Exchange Commission (SEC) rules regarding shareholder access address this issue from a number of different angles. On the one hand, the SEC has recently proposed Rule 14a-11. The proposed rule would allow shareholders to submit—on the corporation’s proxy statement—a separate slate of candidates for shareholder approval.⁵ The rule (and its underlying policy) has received widespread attention of late, precisely because it allows shareholders to have a direct and immediate say in board elections by presenting an alternative slate of candidates to management’s. Some say that allowing this type of direct shareholder access to the ballot would go a long way to alleviate some of the inherent accountability issues that led to the current financial crisis.⁶

Another way that the SEC has approached shareholder access to the ballot is with Rule 14a-8(i)(8). Rule 14a-8(i)(8) had experienced many iterations and proposed changes in recent years. From 1976 to 2006, the rule remained unchanged; then, in 2006, the Second Circuit’s decision in *American Federation of State, County and Municipal Employees v. American International Group, Inc. (AFSCME v. AIG)*,⁷ re-interpreted the rule in a way more favorable to shareholders. In 2007, the SEC amended Rule 14a-8(i)(8) to invalidate the Second Circuit’s decision in *AFSCME v. AIG*. Finally, in June 2009, the SEC proposed a new rule interpretation that would, in essence, reverse course and adopt the Second Circuit’s decision.

As it is currently written, the rule provides that corporations may exclude from its ballot a shareholder proposal that relates in *any way* to director elections, even if that proposal would not immediately affect a director election. However, the rule as drafted at the time of the Second Circuit’s decision in *AFSCME v. AIG* lent itself to another possible interpretation: that, while shareholder proposals that would immediately affect director elections would be excluded under 14a-8(i)(8), shareholder proposals that would institute procedures that would affect *future* director elections would not be excluded.

4. See, e.g., Blake H. Crawford, *Eliminating the Executive Overcompensation Problem: How the SEC and Congress Have Failed and Why the Shareholders Can Prevail*, 2 J. BUS. ENTREPRENEURSHIP & L. 273, 313 (2009).

5. The rule would be subject to several limitations; for instance the proposal contemplates restrictions on the type of shareholder that would be able to put forth a slate of candidates. Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024 (proposed June 18, 2009) (to be codified at 17 C.F.R. § 240.14a-11).

6. See Memorandum from Willkie Farr & Gallagher L.L.P. to Client 1 (June 23, 2009), available at http://www.willkie.com/files/tbl_s29Publications%5CFileUpload5686%5C3013%5CSEC_Proposes_Rules_to_Facilitate.pdf (“According to the SEC, providing greater shareholder involvement in the nomination process will lead to increased accountability and responsiveness of companies and boards of directors to shareholder interests, helping to restore investor confidence.”).

7. 462 F.3d 121 (2d Cir. 2006) (holding that a shareholder proposal that would establish procedural rules governing elections generally could not be excluded from corporate proxy materials under Rule 14a-8(i)(8)).

Advocates for greater shareholder access to boardrooms looked to the case—and the SEC’s subsequent response—as an opportunity for shareholders to achieve “real corporate governance” in the companies in which they own stock.⁸ Many waited with eager anticipation for the SEC to change the rule.

Yet, in 2008—less than nine months before the financial crisis hit—the SEC did not adopt the proposed rule that would have allowed for greater shareholder access.⁹ Instead, the SEC chose to *strengthen* the exclusion and, in so doing, made clear that rules enabling a process-oriented function for director elections would not be met with favor.

This was the first time since 1976 that the SEC used its rule-making function to specifically examine the “election exclusion” provision of the proxy rules and determine how this exclusion contributed to the overall framework of proxy access. As such, because of the unique nature of the “election exclusion” (and its impact on other parts of proxy access), the SEC’s decision to strengthen the exclusion was a missed opportunity for the SEC to delegate oversight to a group of stakeholders with the seemingly greatest incentive to increase corporate accountability—the shareholders.

An argument such as this—that in the wake of a crisis more oversight is needed¹⁰—is not a novel one. In fact, many of the previous calls to arms regarding shareholder access have been done within this context.¹¹ What hasn’t been done yet, however, is a critical analysis of why *this particular provision*—changes to Rule 14a-8(i)(8) as embodied in *AFSCME v. AIG*—is so important. In failing to change this procedural rule, the SEC passed up an opportunity to empower shareholders by providing a *process-oriented* approach to the issues of corporate governance and corporate accountability.

Indeed, while there have been a number of articles that have discussed corporate governance and proxy access in general, very few have taken up the issue of Rule 14a-8(i)(8) specifically, or how it fits within the overall paradigm of shareholder voting. Instead most commentators have focused on iterations of proposed Rule

8. See Jeff Kominsky, *Access Granted: Proxies and the SEC*, 2 ENTREPRENEURIAL BUS. L.J. 573, 573, 589 (2007) (noting that *AFSCME v. AIG* “opened the door” for greater shareholder access, which would encourage “more dialogue, negotiation, and constructive engagement” and facilitate improvement of U.S. corporate governance standards).

9. See Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450, 70,453 (Dec. 11, 2007) (codified at 17 C.F.R. § 240.14a-8(i)(8) (2008)) (“The amendment that we are adopting today is intended to clarify the meaning of Rule 14a-8(i)(8) by codifying the agency’s longstanding interpretation of the rule.”).

10. See Henry Klehm III, *Current Issues in Broker-Dealing Regulation in the Post-Credit Crisis Environment, in COPING WITH BROKER/DEALER REGULATION AND ENFORCEMENT 2008*, at 801, 810–12 (PLI Corporate Law & Practice, Course Handbook Series No. 14081, 2008) (discussing the Federal Reserve Board’s reaction to the incidents surrounding the collapse of Bear Sterns).

11. See Richard Morrissey, *Shareholder Proxy Access Sullivan & Cromwell Briefing, August 23, 2007, in SEVENTH ANNUAL INSTITUTE ON SECURITIES REGULATION IN EUROPE: A CONTRAST IN EU & US PROVISIONS*, at 629, 634–37 (PLI Corporate Law & Practice, Course Handbook Series No. 13750, 2007) (discussing past proposals to SEC Rule 14a-8(i)(8)).

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14a-11 (which, some argue would bypass the need for 14a-8(i)(8) altogether)¹² or, more recently, the idea of the majority vote movement in the realm of corporate governance.¹³

However, there is a unique advantage to having a procedural-based rule such as Rule 14a-8(i)(8). Examining social psychology research and legal procedural justice theory can show how Rule 14a-8(i)(8) is important to corporate governance solutions precisely because it is process-driven, in contrast to Rule 14a-11, which is outcome-driven and, as such, of less value for the long-term impact of shareholder participation.¹⁴ By examining the specific provision of Rule 14a-8(i)(8) from this perspective, I hope to shed light on a part of the debate that has not yet been discussed: namely, that the process-driven nature of the election exclusion and potential revisions under Rule 14a-8(i)(8)¹⁵ offer a unique opportunity for shareholder empowerment that cannot be underestimated.

This examination is extremely relevant. As it stands now, the two main rules that deal with proxy access are in a state of flux. Rule 14a-8(i)(8), as amended, was adopted by the SEC in January 2007. However, as mentioned earlier, the SEC (under a new chairman) has proposed more changes to Rule 14a-8(i)(8), which would effectively overturn the 2007 amendments and make clear that shareholders would have access to proxy ballots to institute procedures that would impact future director elections.¹⁶ In addition, in the same proposing release, the SEC proposed Rule 14a-11, which provides for direct shareholder nominations of directors at the company's expense. Pundits feel that given the political makeup of the Commis-

12. See Andrew D. Ledbetter & Sanjay M. Shirodkar, *SEC Proposes Shareholder Access Rules: Expect Changes to the Director Nomination Process*, DLA PIPER PUBLICATIONS, June 30, 2009, <http://www.dlapiper.com/sec-proposes-shareholder-access-rules:expect-changes-to-the-director-nomination-process/> (noting that proposed Rule 14a-11 would greatly diminish the effect of Rule 14a-8(i)(8)).

13. Jay Razzouk, Comment, *The Momentum, Motive and Mouse-Kapades of the Majority Vote Movement*, 1 J. BUS. ENTREPRENEURSHIP & L. 391 (2008).

14. This essay is the first step in a larger research process that I would like to undertake to examine theories of procedural justice with the specific purpose of applying those theories to the arena of corporate governance. While many have debated the merits of corporate voting and shareholder access generally, there is a dearth of literature that examines the corporate governance structure using procedural justice theory as a conceptual framework (although some have done so within the larger context of democracy and governance theory generally). But see James McConvill, *Shareholder Empowerment as an End in Itself: A New Perspective on Allocation of Power in the Modern Corporation*, 33 OHIO N.U. L. REV. 1013 (2007). Filling this gap is crucial. Sociology and psychology literature is replete with examples of people using various processes to gain empowerment in different democratic contexts. Extrapolating these perspectives and applying them to the area of corporate governance would, I believe, lead to new insight regarding shareholder empowerment and increased corporate accountability.

15. Currently there is a proposed rule before the SEC that would revise the election exclusion into a more shareholder-friendly procedure. Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024 (proposed June 18, 2009) (to be codified at 17 C.F.R. § 240.14a-11); see *infra* Parts III–IV.

16. Under either the current rule or the proposed rule, shareholders would not be able to use Rule 14a-8(i)(8) to submit director nominations for current director elections. See *infra* notes 67–70, 76–80 and accompanying text.

sioners, some form of the rule will almost assuredly pass.¹⁷ As such, one of the battlegrounds in the latest stage of the proxy access war is determining how much of the SEC's proposed release will pass. Both proponents and opponents are focusing the bulk of their attention (and ammunition) on either encouraging or discouraging the SEC to promulgate Rule 14a-11. What this essay hopes to do is refocus the debate so that Rule 14a-8(i)(8) can take its rightful position as an important weapon in the war for greater shareholder access and corporate accountability.

Part one of this essay will discuss the rule, including a brief analysis of proxy access generally and the "election exclusion" specifically. Part two will examine the *AFSCME v. AIG* case and the SEC's response thereto in more detail—discussing the arguments posited both for and against increased shareholder access, as well as the aftermath of the SEC's decision. Part three will analyze how the SEC's failure to change Rule 14a-8(i)(8) to allow greater shareholder access specifically caused one thread in the financial crisis—as a direct result of a loss of shareholder empowerment. Finally, part four offers an epilogue—a discussion of the SEC's current position on shareholder access generally and the election exclusion specifically as a portent for the future.

I. PROXY ACCESS AND THE "ELECTION EXCLUSION"

Rule 14A is a complex set of standards and exceptions that has shareholder proposals to proxy statements as its unifying theme. While Rule 14A has a myriad of principles and provisions that relate to the proxy rules,¹⁸ seemingly the most examined parts of the rule are those that relate to shareholder access to proxy statements for the purpose of nominating directors.¹⁹ Over the years, the SEC has adopted (and then rescinded) proxy access rules that would have allowed shareholders to use management's proxy materials to propose its own pick of directors.²⁰ As it stands today, no such provision exists in the rules. As a result, there are currently only a few choices for shareholders who wish to nominate a slate of directors. For instance, dissatisfied shareholders are allowed to wage a proxy contest, subject to all the exclusions and exceptions currently encompassed in the proxy

17. See Jeffrey McCracken & Kara Scannell, *Fight Brews as Proxy Access Nears—Companies Race to Derail or Soften SEC Plan; 'Ultimate Vehicle' for Activists*, WALL ST. J., Aug. 26, 2009, at C1.

18. For instance, Rule 14a-9 states that it is a violation of the securities laws for companies to make a false statement in its proxy solicitation materials. 17 C.F.R. § 240.14a-9 (2009).

19. In 1942, the Commission considered and rejected a staff proposal that "minority stockholders be given an opportunity to use the management's proxy material in support of their own nominees for directorships." DIV. OF CORPORATE FIN., U.S. SEC. & EXCH. COMM'N, STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS 2 (2003), available at <http://www.sec.gov/news/studies/proxyreport.pdf> [hereinafter STAFF REPORT] (quoting Exchange Act Release No. 3347 (Dec. 18, 1942)).

20. Historically, the SEC has proposed Rule 14a-11 a number of different times. The rule would allow (in certain instances) shareholders to use management's proxy statement to nominate directors. See Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 7760, Exchange Act Release No. 42,055, Investment Company Act Release No. 24,107, 64 Fed. Reg. 61,408, 61,414 n.68 (Nov. 10, 1999) (codified at 17 C.F.R. pt. 240) (rescinding without explanation Rule 14a-11).

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rules.²¹ They may also withhold their vote for management's slate of directors, which may send a strong message to management²² but has no practical effect on the immediate outcome of the election.²³

When most commentators discuss the idea of proxy access, the conceptual underpinnings concern the right of shareholders to advance their own slate of director nominations, with minimal costs to the shareholders.²⁴ There is a practical reason for this: the cost of mounting a separate shareholder-led slate of candidates is enormous.²⁵ As such, having management pay for the cost of shareholder nominations is a crucial provision of shareholder access. For instance, if the shareholder does wish to wage a proxy contest, he or she must pay the costs of preparing a separate proxy ballot.²⁶ This cost is enormous.²⁷ As such, advocates for increased shareholder access have petitioned the SEC for a rule that would require management to include shareholder nominations for board seats in the company's own proxy statements. The most recent incarnation of this comes in proposed Rule 14a-11 as embodied in SEC Release No. 34-60089.²⁸

The text of the proposed rule reads as follows:

*In connection with an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors are elected, a registrant . . . will be required to include in its proxy statement and form of proxy the name of a person or persons nominated by a shareholder or groups of shareholders for election to the board of directors and include in its proxy statement the disclosure about such nominee or nominees and the nominating shareholder or members of a nominating shareholder group*²⁹

21. See Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024, 29,027 (proposed June 18, 2009) (to be codified at 17 C.F.R. § 240.14a-11).

22. See *infra* Part III (providing as an example of an effective "withhold vote" campaign the ousting of Michael Eisner at Disney).

23. See Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,028 (noting that with regard to companies using plurality voting, when there are as many nominees as open board positions, any nominee receiving only one vote will be elected regardless of how many votes are withheld).

24. See Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475, 481 (2008) (discussing corporate governance activism and noting the increased attention to the right of shareholders to elect directors and the prohibitive cost of proxy contests).

25. In a recent comment letter filed with the SEC, Automatic Data Processing, Inc. reported that the average cost to mount a proxy contest was \$368,000, based on proxy statements filed by outsiders during 2003–2005; the letter also noted that the reported estimates were likely lower than the actual costs incurred. See Letter from Richard J. Daly, Co-President, Automatic Data Processing, Inc., to Nancy M. Morris, Sec'y, Sec. & Exch. Comm'n (Apr. 20, 2006), available at <http://www.sec.gov/rules/proposed/s71005/ccallan1565.pdf>.

26. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,028.

27. 11 SIMON LORNE & JOY MARLENE BRYAN, ACQUISITIONS & MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 4:47 (2009) (describing the essential costs of mounting a proxy contest as "substantial").

28. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,082–85.

29. *Id.* at 29,082.

The requirement is, of course, based on certain thresholds of eligibility that the shareholders or group of shareholders must meet (such as holding a certain amount of stock or holding the company's shares for a certain length of time).³⁰ Nonetheless, the rule would allow shareholders direct access to the company's proxy statements and give them the ability to directly affect the outcome-specific board elections.³¹

In contrast to the provisions of Rule 14a-11, Rule 14a-8(i)(8) relates to other shareholder provisions that companies must include in their proxy statements. However, the exceptions contained in the rule tend to attract the most controversy.³² More than thirteen exceptions exist under Rule 14a-8; instances when the company may exclude shareholder provisions.³³ One of the exclusions, and the focus of this essay, is found in Rule 14a-8(i)(8),³⁴ which relates to shareholder proposals for elections. From 1976 until 2007, the text of the "election exclusion" read as follows:

This section addresses when a company must include a shareholder's proposal in its proxy statement. . . . Under a few specific circumstances, the company is permitted to exclude your proposal, but only after submitting its reasons to the Commission.

. . . .

*. . . [A proposal may be excluded if it] relates to an election for membership on the company's board of directors or analogous governing body*³⁵

Most of the attention in the last five years has focused on the word "relates."³⁶ Institutionally, the SEC's position is that the language of 14a-8(i)(8) would permit

30. *Id.* at 29,083.

31. *Id.* at 29,073.

32. See, e.g., J. Robert Brown, *The SEC, Corporate Governance and Shareholder Access to the Board Room*, 2008 UTAH L. REV. 1339, 1359–61 (discussing the long-standing contention over granting shareholders greater involvement in the nomination process); Patricia R. Uhlenbrock, *Roll Out the Barrel: The SEC Reverses Its Stance on Employment-Related Shareholder Proposals Under Rule 14a-8—Again*, 25 DEL. J. CORP. L. 277, 279 (2000) (noting a controversial exception under Rule 14a-8 relating to "ordinary business" matters).

33. 17 C.F.R. § 240.14a-8 (2009).

34. 17 C.F.R. § 240.14a-8(i)(8).

35. Shareholder Proposals, 17 C.F.R. § 240.14a-8(i)(8) (2007) (emphasis added). In 2007 (in the wake of the Second Circuit's decision in *AFSCME v. AIG*), the SEC amended Rule 14a-8(i)(8). Compare 17 C.F.R. § 240.14a-8(i)(8) (2007) ("[A proposal may be excluded i]f the proposal relates to an election for membership on the company's board of directors or analogous governing body"), with 17 C.F.R. § 240.14a-8(i) (2008) ("[A proposal may be excluded i]f the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election").

36. See, e.g., Gary M. Brown, *Recent Developments in '34 Act Practice*, in *SECURITIES FILINGS 2008*, at 425, 431–33 (PLI Corporate Law & Practice, Course Handbook Series No. 1697, 2008) (contrasting the Commission's decision to allow AIG to exclude AFSCME's proposal from proxy materials based on its interpretation of the "relat[ing] to" language with the Second Circuit's reversal of the SEC decision based on a more narrow interpretation of Rule 14a-8(i)(8)).

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companies to exclude shareholder proposals that in *any way* relate to elections, whether through the process of elections generally or the outcome of a specific election.³⁷ However, the “relates” language of the rule can also be read narrowly so that companies can only exclude shareholder proposals that relate to a specific election, i.e., a specific slate of directors. Commentators argue that this limited form of shareholder access is consistent with the fundamental structure of our corporate governance framework.

Under current theoretical models of corporate accountability, ownership of the firm and management of the firm are conceptually distinct—unlike traditional notions of ownership (such as those embodied in property rights),³⁸ most theoretical models of the corporation hold that the management of the corporate entity should be held in the hands of a few people, separate and apart from the legions of people who actually “own” the firm, i.e., its shareholders.³⁹ There is logic in this theoretical construct—the modern day public corporation can have potentially millions of “owners,” each with his own distinct notion of what is the best course of action to take for the management of the firm. Allowing all the shareholders to have a voice in the day-to-day operations and overall management of the corporation would create an unwieldy impossibility. Instead, the theory of the firm involves giving over the management and operations to corporate officers with oversight maintained in a board of directors—many of whom are often also the corporate officers in the firm.⁴⁰

While this construct can dramatically increase the efficiency of operations and management, two related, undesirable outcomes may potentially result from this structure. First, whenever management’s incentives deviate from the best interests of the firm (i.e., with regard to executive compensation), there is no mechanism in place under this model for allowing the firm’s interest to take precedence. Second, if management wishes to engage in deviant behavior (such as looting the firm), there is little owner-led accountability in place to prevent it from doing so.

Given these disincentives, an important part of the ideal firm structure is a mechanism for shareholder engagement; under current firm models, this mechanism is shareholder voting rights. Under the immutable rules of the firm, shareholders have the right to vote for the corporation’s management.⁴¹ This right cannot be contracted away—even if a corporation attempts to contract around this right by providing for a different mechanism in the firm’s bylaws, such a provision

37. See *infra* notes 57–59 and accompanying text.

38. See William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 *STAN. L. REV.* 1471, 1483–85 (1989) (discussing property rights as the more traditional view of the corporate control).

39. *Id.*

40. *Id.*

41. See Peter N. Flocos, *Toward a Liability Rule Approach to the “One Share, One Vote” Controversy: An Epitaph for the SEC’s Rule 19c-4?*, 138 *U. PA. L. REV.* 1761, 1786 (1990) (discussing the shareholder vote as an immutable rule).

would not be allowed under American corporate law. The shareholders thus act as a final check against the exigencies of management's self-interest: in theory, if a shareholder feels as if management is behaving badly it can simply exercise its immutable right and oust management in the next director elections.

However, notwithstanding the theoretical underpinnings, the practical structure of most corporations prevents this right from turning into any meaningful power. For instance, under current proxy access laws, it is within the management's sole discretion to issue a slate of candidates for annual elections.⁴² Almost invariably, corporate management will select only one candidate for any particular position, almost guaranteeing that the nominee will be unopposed. If a shareholder wishes to nominate an alternative candidate, under the current rules, the shareholders must mail to other shareholders an entirely separate ballot; the shareholder's candidate will not appear on the corporation's proxy.⁴³ In addition, under the current structure of most public corporations, the slate of directors is voted on as a whole, so that votes must be cast for all or none of the candidates.⁴⁴ In addition, most ballots do not give shareholders the ability to either write in a candidate or oppose the slate.⁴⁵ If a shareholder is unsatisfied with management's choices, her only alternative is to withhold her vote, i.e., not vote on the candidates.⁴⁶ However, under most corporate structures, this has no practical effect because most corporations will allow a director to be elected by a plurality—a director can be placed on the board with simply one vote.⁴⁷

Given this current corporate structure, shareholder access has been the subject of much scrutiny by commentators, advocates, and the SEC. While other parts of the shareholder access rule have been the subject of the SEC's rule-making authority, the last major rule change for the "election exclusion" was in 1976, when the SEC changed the format of the rule to a question and answer format.⁴⁸ After the 1976–1977 season, the election exclusion remained in relative obscurity until 2004,

42. See Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1164 (1993).

43. *Id.* at 1141.

44. *Id.*

45. *Id.* at 1168–69 (noting the limited options when opposing a slate of directors).

46. *Id.*

47. See Richard C. Ferlauto, *Committee on Corporate Laws Discussion Paper on Voting by Shareholders for the Election of Directors, June 22, 2005*, in THIRD ANNUAL DIRECTORS' INSTITUTE ON CORPORATE GOVERNANCE, at 473, 480 (PLI Corporate Law & Practice, Course Handbook Series No. 6343, 2005) (discussing current plurality votes allowing for a single vote needed for successful election of officers).

48. At the time of the 1976 proposals, the Staff of the Division of Corporation Finance stated "with respect to corporate elections . . . Rule 14a-8 is not the proper means for conducting campaigns or effecting reforms in elections of that nature." *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc.*, 361 F. Supp. 2d 344, 346–47 (S.D.N.Y. 2005), *rev'd*, 462 F.3d 121 (2d Cir. 2006) (quoting Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 12,598, [1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,634, at 86,600 (proposed July 7, 1976)).

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when the actions of AFSCME brought the rule to the front and center of the shareholder access debate.⁴⁹

II. *AFSCME V. AIG* AND THE SEC'S RESPONSE

In 2004, AFSCME, a pension-plan shareholder, proposed a rule that would be incorporated into AIG's proxy solicitation.⁵⁰ The proposal did not request a specific slate of directors (which would have led to a contested election); rather it was a bylaw proposal that would require AIG to include shareholder director nominees in future proxy statements so long as certain provisions were met. The distinction was crucial: if AFSCME had introduced an outcome-based proposal regarding the current slate of directors, it would have been excluded outright under the plain language of Rule 14a-8(i)(8); in contrast, it was less clear whether the proposed bylaw, which would only affect the process of elections in the future, would fall under the exclusion embodied in 14a-8(i)(8).

This was not the first time that AFSCME had attempted to change a company's governing documents to reflect a more access-friendly regime. In fact, on a number of previous occasions, the pension fund had proposed similar measures with various companies.⁵¹ On each previous occasion, the SEC allowed the companies to

49. *AFSCME*, 361 F. Supp. 2d at 345–47; see Gordon, *supra* note 24, at 485.

50. *AFSCME*, 361 F. Supp. 2d at 345–46. The text of AFSCME's proposal is as follows:

The Corporation shall include in its proxy materials for a meeting of stockholders the name, together with the Disclosure and Statement (both defined below), of any person nominated for election to the Board of Directors by a stockholder or group thereof that satisfied the requirements of this section 6.10 (the 'Nominator'), and allow stockholders to vote with respect to such nominee on the Corporation's proxy card. Each Nominator may nominate one candidate for election at a meeting.

To be eligible to make a nomination, a Nominator must:

(a) have beneficially owned 3% or more of the Corporation's outstanding common stock (the "Required Shares") for at least one year,

(b) provide written notice received by the Corporation's Secretary within the time period specified in section 1.11 of the Bylaws containing (i) with respect to the nominee, (A) the information required by Items 7(a), (b) and (c) of SEC Schedule 14A (such information is referred to herein as the "Disclosure") and (B) such nominee's consent to being named in the proxy statement and to serving as a director if elected; and (ii) with respect to the Nominator, proof of ownership of the Required Shares; and

(c) execute an undertaking that it agrees to (i) assume all liability of any violation of law or regulation arising out of the Nominator's communications with stockholders, including the Disclosure; (ii) to the extent it uses soliciting material other than the Corporation's proxy materials, comply with all laws and regulations relating thereto.

The Nominator shall have the option to furnish a statement, not to exceed 500 words, in support of the nominees' candidacy (the "Statement"), at the time the Disclosure is submitted to the Company's Secretary. The Board of Directors shall adopt a procedure for timely resolving disputes over whether notice of a nomination was timely given and whether the Disclosure and Statement comply with this section 6.10 and SEC rules.

Id.

51. See, e.g., Press Release, AFSCME, AFSCME Calls for Increased Activism, Details Proxy Access Campaign to Public Pension Funds (Nov. 26, 2002), available at <http://www.afscme.org/press/6945.cfm>; Press Re-

exclude AFSCME's proposal.⁵² However, in this instance, the pension fund took a different tack. After the SEC issued its no-action letter, the fund sued AIG in the Southern District of New York.⁵³ Not surprisingly, the District Court ruled quickly in AIG's favor, finding that the SEC's policy had consistently allowed for exclusions that related to elections, even if the proposal was not for a specific election or a specific slate of directors.⁵⁴ Many thought the matter would be closed.⁵⁵ However, to the surprise of many, the Second Circuit reversed, holding that AIG must include AFSCME's bylaw proposal in its proxy materials.⁵⁶

In the briefs filed during the appeal, the SEC submitted an amicus brief to the court detailing its position: the SEC found that the no-action letter issued to AIG for excluding the bylaw proposal was appropriate.⁵⁷ The SEC also found that the exclusion under 14a-8(i)(8) should apply both to proposals for a current slate of directors and for binding and non-binding resolutions that would make the election of a future slate of directors easier.⁵⁸ As such, the SEC argued that the rule excluded not just specific election provisions but policies and procedures that related to elections generally.⁵⁹

The Second Circuit disagreed. The court found that the SEC's provision was ambiguous and that the SEC's interpretation of the provision over the past thirty years had shifted.⁶⁰ As a result, the court held that the language of 14a-8(i)(8) created an exclusion and that the exclusion related only to a current slate of directors.⁶¹ As such, the court ruled that AFSCME's proposal, which related to a bylaw

lease, AFSCME, AFSCME Pension Plan Appeals SEC Staff Recommendation on Proxy Access Proposal, Calls on Full Commission to Permit Shareholder Vote at Citigroup, Five Other Companies (Feb. 27, 2003), available at <http://www.afscme.org/press/7066.cfm>.

52. See Kominsky, *supra* note 8, at 573.

53. AFSCME, 361 F. Supp. 2d at 345.

54. *Id.* at 347.

55. See, e.g., Brown, *supra* note 32, at 1342, 1365 (noting that, in 2005, "[t]he proposal for shareholder access remained officially outstanding but effectively dead" and that "[b]ureaucratic inertia was thrown into disarray by the Second Circuit's decision in *AFSCME v. AIG*").

56. AFSCME v. AIG, 462 F.3d 121 (2d Cir. 2006) (overturning the district court's decision and holding that the "relates to election" exception was not applicable and that, therefore, the corporation could not exclude the proposed bylaw). One commentator equated the ruling as reaching the "holy grail." See Press Release, AFSCME, McEntee Calls 2nd Circuit Ruling "Holy Grail" of Corporate Governance Reform (Sept. 7, 2006), available at <http://www.afscme.org/press/11224.cfm>. Just prior to the AIG proposal, the SEC, while denying AFSCME's proposal, issued a statement through the Division of Corporation Finance that it would "examine current proxy regulations and develop possible changes to those regulations to improve corporate democracy." Press Release, U.S. Sec. & Exch. Comm'n, Commission to Review Current Proxy Rules and Regulations to Improve Corporate Democracy (Apr. 14, 2003), available at <http://www.sec.gov/news/press/2003-46.htm>.

57. See AFSCME, 462 F.3d at 126 (noting that in its amicus brief, the Commission interpreted Rule 14a-8(i)(8) to exclude AFSCME's proxy access bylaw).

58. *Id.*

59. *Id.*

60. *Id.* at 123, 126.

61. *Id.* at 127.

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governing future director elections, did not fit within the exclusion under 14a-8(i)(8) and therefore should not have been excluded.⁶²

In the wake of the *AFSCME* case, the issue of interpreting Rule 14a-8(i)(8) became a priority. In July 2007, the SEC issued two proposing releases dealing with the election exclusion provision. The two proposals were unusual in that they offered two competing visions of the election exclusion—one in which the exclusion was read broadly (such as AIG had argued was the proper interpretation) and one in which the election exclusion was construed narrowly (in the way that the Second Circuit argued it should be read).⁶³ Then-Chairman Cox was the swing vote that led to the release of both proposed rules.⁶⁴ At the time, Chairman Cox stated that he was supporting the competing visions because he wanted to facilitate a public debate on shareholder access.⁶⁵

The first proposed rule advocated a broad interpretation of the election exclusion.⁶⁶ Under this proposed rule, any shareholder proposal that related to both the election of directors or *procedures* that affected the election of directors would be excluded.⁶⁷ It was this version that the SEC eventually adopted.⁶⁸ The second proposal would have offered a narrow reading of the election exclusion.⁶⁹ Under this proposed rule, shareholders would be able to submit proposals that would affect procedures relating to director elections generally (although procedures that would affect specific director elections would still be excluded).⁷⁰

In December 2007, the SEC adopted the broad interpretation. The amended rule states that a shareholder's proposal can be excluded: "[i]f the proposal relates to a *nomination* or an election for membership on the company's board of directors or

62. *Id.* at 127–29. The decision was not petitioned to the Supreme Court.

63. In fact, during hearings on the matter, Representative Barney Frank called it “regulating in the alternative,” which he described as “a new concept to me.” *SEC Proxy Access Proposals: Implications for Investors: Hearing Before the House Comm. on Fin. Serv.*, 110th Cong. 1 (2007), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:39542.wais.

64. Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the Open Meeting: Meeting the Competitive Challenges of the Global Marketplace 126, 181 (July 25, 2007), http://www.sec.gov/news/openmeetings/2007/openmtg_trans072507.pdf [hereinafter *Competitive Challenges*] (noting that Chairman Cox and Commissioners Campos and Nazareth voted in favor of releasing the narrow “long release,” with Commissioners Atkins and Casey voting against it, stating it was too narrow in its current form; and that Chairman Cox and Commissioners Atkins and Casey voted in favor of releasing the “short release,” with Commissioners Campos and Nazareth voting against it due to the broad nature of the release).

65. See *Competitive Challenges*, *supra* note 64, at 126 (“By advancing two very different proposals, we’ll have the benefit of the full breadth of commentary about different ways of attacking the issue. . . . This approach will also give us a richer context in which to evaluate public comment concerning the potential costs and benefits of any new rule. . . .”).

66. See *Shareholder Proposals Relating to the Election of Directors*, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,493 (proposed Aug. 3, 2007).

67. *Id.*

68. The final rule allowed companies to exclude shareholder access proposals—ones that would result in either an “immediate or future election contest.” *Id.*

69. *Shareholder Proposals*, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007).

70. *Id.*

analogous governing body or a procedure for such nomination or election.”⁷¹ In adding the final clause to the rule, the SEC stated that:

*We believe that the clarifying rule amendment is consistent with the agency’s longstanding interpretation of the election exclusion and that the references to “nomination” and “procedure” in the rule text appropriately reflect the purpose of the exclusion.*⁷²

Rather than amending the rule to allow a narrow interpretation of the election exclusion (which would have broadened proxy access), the SEC instead added language that overturned the effect of the Second Circuit’s decision in *AFCSME*.

III. THE SEC’S FAILURE TO ALLOW GREATER SHAREHOLDER ACCESS CONTRIBUTED TO THE FINANCIAL CRISIS

So how does this relate to the financial crisis?

As more time has passed since the beginning of the financial crisis, one of the central themes that has emerged has been a lack of regulatory oversight by federal agencies, including (chiefly) the SEC.⁷³ However, to blame the downfall of the markets on a lack of oversight is taking an overly simplistic view of things. The SEC, like most government agencies, is overtaxed.⁷⁴ Its ability to monitor the various boards would be untenable (and not a part of the SEC’s job description). Having an intermediate set of individuals who can monitor the corporation on behalf of the shareholders would provide a crucial step currently missing along a continuum of oversight that includes the government, management itself, and the public at large.

As such, a more shareholder-friendly regime is one way to develop more oversight in the corporate governance process. As one commentator noted:

Many of the problems with Wall Street lie with the corporate structure itself. In the idealized world, management should be acting for the benefit of the shareholders, and the shareholders should act through the board of directors to set . . . [the] power of management. In the real world, though, shareholders are too

71. See Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450, 70,456 (Dec. 11, 2007) (codified at 17 C.F.R. § 240.14a-8(i)(8) (2008)).

72. *Id.* at 70,454.

73. See, e.g., Sudeep Reddy, *The Financial Crisis: Fed’s Performance Under More Scrutiny*, WALL ST. J., Sept. 23, 2008, at A8 (noting that the financial crisis exposed failures across many agencies, including the SEC).

74. Scot J. Paltrow, *Dark Side of the Street: Why Scandals Continue to Erupt*, WALL ST. J., Dec. 23, 2002, at C1 (explaining that the risk of firms getting caught misbehaving is small because the SEC, the securities industry’s main regulator, is “overtaxed and chronically underfunded”).

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*numerous to exert any meaningful control, with the result that management tends to operate in a way that favors itself over shareholders.*⁷⁵

However, in order to optimize a system of accountability and governance that would prevent future crises, a regulatory framework must be in place that increases participation and engagement from all sectors. To that end, having a procedural-based rule such as Rule 14a-8(i)(8) is advantageous precisely because it allows for increased engagement on the part of shareholders. Moreover, the use of legal procedural justice theory highlights how Rule 14a-8(i)(8) can be used as a potential solution to corporate governance issues because of its process-driven nature and subsequent impact on shareholder participation.

The link is in the power of the process.

Unlike proposed Rule 14a-11, which, as an outcome-based solution, gives shareholders the power only to directly nominate board members,⁷⁶ Rule 14a-8(i)(8) (as contemplated by the court in *AFSCME*) deals with the procedure for certain shareholder proposals. No shareholder proposal brought pursuant to Rule 14a-8(i)(8) (under any of its incarnations) would result in instant changes to the composition of boards of directors. Instead, the rule merely allows shareholders to make changes to the company's bylaws. As such, getting shareholders involved, in a meaningful way, in the process of changing the corporate governance structure could have far-reaching impact beyond any one particular election. And, while shareholders might not have the instant gratification that would be gained from a victory in a specific election, a much greater impact could come from thinking about the underlying fundamental structure of a company and finding ways to change that structure in a way that best suits the shareholders' needs.

This difference in the method of engagement, i.e., in process-oriented engagement versus outcome-oriented engagement, is significant. In essence, both methods present a framework for accessing power⁷⁷—using tools to influence change within a particular structure or system (in this case the firm). As such, finding the best tools for influence can significantly increase a shareholder's ability to affect change. It is within this context that process-driven rules become significant: legal and sociological research have shown that the procedural methods for accessing justice can

75. Bill Brown, *Uncle Sam as Sugar Daddy*, MARKETWATCH, Nov. 19, 2008, <http://www.marketwatch.com/story/moral-hazard-uncle-sam-as-sugar-daddy>.

76. See Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024, 29,031 (proposed June 18, 2009) ("The Commission's proposals would provide shareholders with two ways to more fully exercise their rights to nominate directors.").

77. Social scientists generally define power as "the ability of people to influence the distribution of resources among the members of society." Tom R. Tyler, *Justice and Power in Civil Dispute Processing*, in JUSTICE AND POWER IN SOCIOLEGAL STUDIES 309, 309 (Bryant G. Garth & Austin Sarat eds., 1998). In the corporate context then, accessing power would give shareholders the ability to influence how the corporation's resources are allocated—whether for the benefit of the firm, the benefit of management, or the benefit of society as a whole.

be just as significant in determining whether social justice is promoted as substantive (or outcome-driven) issues.⁷⁸ In short, to use process is to access power in a way that produces long-term engagement on behalf of participants.

In essence then, the contrast between proposed Rule 14a-11 and Rule 14a-8(i)(8) is—at its foundations—a difference between an outcome-based and a process-based regime. Under an outcome-based regime, stakeholders are involved in achieving a particular end: usually the election of a specific official (in the case of general democracy structures) or a specific slate of directors (as in the corporate governance regime). In contrast, process-based regimes encourage stakeholder participation in democratic processes or in governmental structures. Involvement transcends a specific outcome-based model but serves as a recurring mode of engagement in the larger structure (whether it be the governmental structure or the corporate structure).⁷⁹ This is important not just for the rule itself but also for how the government should be using its regulatory authority with regard to shareholder access. This is the model of engagement that would result under proposed Rule 14a-8(i)(8)—shareholders would be able to implement policies, procedures, and processes that could affect multiple board regimes.

This, in turn, would lead investors to feel empowered about voting because, unlike the election of a particular slate, which would serve only as a potential short-term fix, procedural votes could bring about real transformation, making shareholders feel that they can affect long-lasting change in a company—boards come and go, but bylaws endure.⁸⁰ Indeed, commentators who have discussed proposed amendments to Rule 14a-8(i)(8) have cited the self-determination of shareholders as a primary reason for allowing the amendment to pass.⁸¹

78. *Id.* at 310. Much of the literature on procedural access has been written within the context of social change and access to justice scholarship.

79. See Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 91–93 (2008) (discussing shareholders' use of the proposal process to “genuinely influence corporate policy on an ongoing basis”).

80. Cf. Mary-Hunter Morris, *The Price of Advice*, 86 U. DET. MERCY L. REV. 153, 181 (2009) (discussing how empowering shareholders would “serve as a check on managerial influence . . . [because] it is clear that shareholders prefer being empowered to take affirmative steps against excessive executive compensation, rather than merely being fully informed of the problem but powerless to do anything about it”); *id.* at 182 (discussing how giving shareholders access to the proxy in 1992 for executive compensation had a huge effect on Wall Street and with investors).

81. See, e.g., Letter from Stephen Cutler, Gen. Counsel, JPMorgan Chase & Co., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-297.pdf> (discussing proposed rule changes to Rule 14a-8(i)(8) and Rule 14a-11). Mr. Cutler wrote that:

We support the adoption of the proposed amendment to Rule 14a-8(i)(8) that would enable shareholders to make proposals regarding the election of directors. The use of amended Rule 14a-8(i)(8) to enable shareholders to propose procedures for access to the company's proxy materials is an appropriate way for companies and their shareholders to determine a proxy access procedure that is tailored for the particular circumstances of the company (including whether, in lieu of such process, proxy reimbursement would work better for the company and its shareholders).

Id. at 3; see also Letter from Joseph J. Sweeny, Senior Vice President, Gen. Counsel & Corporate Sec'y, Applied Materials, Inc., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 19, 2009), available at <http://>

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The effect of getting shareholders involved in the process can be felt in different ways. For instance, in March 2004, a month-long “unprecedented display of shareholder disapproval” culminated in a substantial share of Disney stockholders voting to withhold support for Michael Eisner, then-CEO and Chairman of Disney.⁸² While the result had no *legal* effect, it set the stage for increased shareholder activism at Disney. In quick succession, a number of proposals followed: for instance, in September 2004, shareholders submitted a resolution encouraging the company to adopt proposed Rule 14a-11 internally.⁸³

Focusing on Rule 14a-8(i)(8) as a process-based model is particularly relevant in light of the issues surrounding the financial crisis. As stated earlier, many of the comments surrounding the systemic failures within the financial sector relate back to the idea of a lack of oversight and regulatory participation.⁸⁴ Having a rule that encourages empowerment through process would (theoretically) beget increased corporate accountability to shareholders. In addition, increased process-based participation by shareholders would (presumably) lead to an increase in shareholders who will be invested and want to *stay* engaged in the process, regardless of the outcome, merely because they are active in the structure.⁸⁵ This has evidence in psychology research on process-based engagement. For instance, some research has shown that engaged participants place a significant value on having a voice in the process, irrespective of the final outcome.⁸⁶

In contrast, the outcome-based model often leads people to become disengaged from the process particularly because a hoped-for outcome was not achieved (for instance, voters who become disengaged from subsequent elections when their specific candidate does not get elected).⁸⁷

www.sec.gov/comments/s7-10-09/s71009-490.pdf (“[T]he proposed Rule 14a-8 amendment would encourage and facilitate greater stockholder participation in a company’s corporate governance, including developing tailored proxy access rules, thereby meeting the SEC’s goal of further democratizing the proxy process.”).

82. Razzouk, *supra* note 13, at 391–92 (reporting that the unprecedented “campaign” resulted in forty-three percent of Disney shareholders withholding their vote from Chairman and CEO Michael Eisner).

83. James Gerkis & Aileen Daly, *SEC Proposed Rule 14a-11: Letting Stockholders Nominate Corporate Directors*, ADMIN. & REG. L. NEWS, 2005 at 9, 9, 11.

84. See *supra* notes 10, 73 and accompanying text.

85. See McConvill, *supra* note 14, at 1049 (“If the governance structure of corporations better facilitated shareholder participation, with shareholders given a real opportunity to have a sense of involvement in the corporation, shareholding could become an important source for facilitating gratifications and building up psychological capital for the future.”).

86. Jenny S. Martinez, *Process and Substance in the “War On Terror”*, 108 COLUM. L. REV. 1013, 1084–85 (2008).

87. This concept of getting involved in the process can have far-reaching outcomes. See ROBERT CIALDINI, INFLUENCE: THE PSYCHOLOGY OF PERSUASION 72–73 (William Morrow & Co. 1993) (1984). In his book, Dr. Cialdini discusses the enormous impact process-driven campaigns can have on the future involvement of citizens in other civic-minded activities, even if the outcomes of the two activities are unrelated (i.e., signing a petition entitled “Keep California Beautiful” led to a marked increase in citizens participating in driver safety campaigns). As the researchers concluded:

What may occur is a change in the person’s feeling about getting involved or taking action. Once he has agreed to a request, his attitude may change, he may become, in his own eyes, the kind of person

The implication of a process-based rule, such as Rule 14a-8(i)(8), is powerful for two reasons. First, providing a mechanism for shareholders to participate in the process allows individuals to become engaged in the corporate structure and governance affairs of the company (for instance, by enacting a procedure that governs corporate structure).⁸⁸ Second, a favorable outcome in the process (such as the successful implementations of new structures under 14a-8(i)(8)) would have additional, long-lasting impact. A secondary consideration for why the process is so important is that by allowing the shareholders to engage in instruments that affect change, a certain amount of legitimacy will be naturally imparted to the outcome, regardless of whether the outcome was the one initially desired by the participants.⁸⁹ As one scholar notes, “democratic government can be valued because it generates legislation through a process of reasoned deliberation and negotiation among a wide variety of viewpoints and interests, thus increasing the likelihood that its laws will serve the common good with, say, *laws generated by a single homogenous elite*.”⁹⁰

Indeed, the genesis of the current state of Rule 14a-8(i)(8) was born out of a desire by AFSCME to be included in the decision-making process. As the pension fund’s Chairman stated in a press release issued when the action was filed: “We have no choice but to seek relief in the courts because of the current stalemate on proxy access rulemaking at the SEC. While we hope that Chairman Donaldson will be able to craft a meaningful shareholder access rule, the current situation at AIG demands action now.”⁹¹

who does this sort of thing, who agrees to requests made by strangers, who takes action on things he believes in, who cooperates with good causes.

Id. at 73 (quoting Jonathan L. Freedman & Scott C. Fraser, *Compliance Without Pressure: The Foot-in-the-Door Technique*, 4 J. PERSONALITY & SOC. PSYCHOL. 195 (1966)). In contrast, low voter turnout in the United States may be explained precisely because it is outcome-driven—since each person is voting for a specific outcome, rather than a process or procedure, then, when that outcome fails to occur, the citizen becomes disengaged.

88. See Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, but Not Too Late*, 43 AM. U. L. REV. 379, 453 (1994) (“Permitting shareholders to nominate directors would go a long way toward providing shareholders with a meaningful role in corporate governance.”). The same is true for shareholder proposals, as fewer restrictions on what may be proposed will allow shareholders to become engaged with corporate operations. See *id.*

89. Christopher J. Peters, *Adjudication as Representation*, 97 COLUM. L. REV. 312, 331 (1997) (“Proceduralist theories emphasize the value that may be derived from . . . the very process of citizens participating in their government.”).

90. *Id.* (emphasis added).

91. Press Release, AFSCME, AFSCME Pension Plan Files Suit Against AIG Seeking a Shareholder Vote on Proxy Access (Feb. 25, 2005), available at <http://www.afscme.org/press/6822.cfm>.

IV. THE SEC'S CURRENT POSITION AND PREDICTIONS FOR THE FUTURE

When I first presented my thoughts on this subject at a conference at the University of Maryland School of Law in April 2009,⁹² the SEC had not yet acted upon, or drawn the connection between, Rule 14a-8(i)(8) and the financial crisis.⁹³ Since then, however, much action has taken place at the Commission to both acknowledge and address this issue.

Chairman Mary Schapiro has drawn an explicit connection between a lack of corporate accountability and the rise of the financial crisis. During a speech in May, 2009, Chairman Schapiro stated:

*Another area where we are seeking to rebuild investors' confidence involves access to corporate proxies. Very soon, the Commission will consider a proposal to ensure that a company's owners have a meaningful opportunity to nominate directors to corporate boards. . . . The proxy access initiative is intended to empower investors and enable them to have a greater say in the nomination of directors of the companies they own. . . . I believe that empowered investors equate to confident investors. It is my expectation that enabling investors to participate meaningfully in the nomination of directors through proxy access will foster a sense of enhanced legitimacy to the director nomination process—and promote investor confidence, as well as accountability among managers and directors.*⁹⁴

Schapiro's language of "empowerment" and "legitimacy" highlights the fundamental underpinnings for process-based rules. The proposed rules at issue would address both process-based rules and outcome-based rules discussed earlier: Rule 14a-8(i)(8) and proposed Rule 14a-11.⁹⁵ The proposed amendments to Rule 14a-8(i)(8) would, in essence, reverse the path the SEC took with the election exclusion under

92. Symposium, Corporate Governance and Securities Law Responses to the Financial Crisis, 5 J. Bus. & Tech. L. (2010) (featuring a roundtable discussion of implications of the current financial crisis on corporate governance and securities law).

93. The importance of shareholders having access to proxies was not addressed until the following month, when Chairman Schapiro and the SEC indirectly stated that proxy access would cure many of the ills that were in part responsible for the financial crisis. Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Address to Mutual Fund Directors Forum Ninth Annual Policy Conference: Critical Issues for Investment Company Directors (May 4, 2009), <http://www.sec.gov/news/speech/2009/spch050409mls.htm>; see also Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024 (proposed June 18, 2009) (proposing amendments to Rule 14a-8 as well as Rule 14a-11).

94. Schapiro, *supra* note 93.

95. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,031. The amendments address the process-based rule, Rule 14a-8(i)(8), by requiring companies, in certain circumstances, to include shareholder proposals in the company's proxy materials, thereby facilitating shareholder involvement in changing the corporate governance structure. See *id.* at 29,056. In addition, the amendments address the outcome-based rule, proposed Rule 14a-11, by requiring companies to include disclosure about shareholder nominees for directors in company proxy materials, consequently affecting outcome-specific board elections. *Id.* at 29,032.

Chairman Cox and allow for shareholder bylaw proposals to be included in management's proxy statements, even if the bylaw relates to an election process.⁹⁶ According to the SEC:

*Our proposed amendment to Rule 14a-8(i)(8), the election exclusion, would enable shareholders to submit proposals that would amend, or that request an amendment to, a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided the proposal does not conflict with proposed Rule 14a-11. As proposed, revised Rule 14a-8(i)(8) would not restrict the types of amendments that a shareholder could propose to a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, although any such proposals that conflict with proposed Rule 14a-11 or state law could be excluded.*⁹⁷

Assuming that some form of Rule 14a-8(i)(8) and Rule 14a-11 will pass, we will be in a unique position to compare the effect of a process-based regime and an outcome-based regime, which are designed to do the same thing: increase shareholder access to corporate governance structures.

Ironically, in the round of comments accompanying the SEC's latest proposed revisions to the two rules, many of the same people who criticized revisions of Rule 14a-8(i)(8) after *AFSCME* are now coming out in support of it.⁹⁸ Given the political reality at the SEC, most believe that some version of these two rules will likely

96. *See id.* at 29,031.

97. *Id.* at 29,065–66.

98. *Compare* Letter from Donna Dabney, Corporate Sec'y & Corporate Governance Counsel, Alcoa, to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n (Sept. 26, 2007), available at <http://www.sec.gov/comments/s7-16-07/s71607-343.pdf> (“[W]e encourage the SEC to . . . continue its long-standing policy of allowing companies to exclude [director-related shareholder] proposals pursuant to Rule 14a-8(i)(8).”), with Letter from Donna Dabney, Vice President, Sec'y & Corporate Governance Counsel, Alcoa, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 14, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-158.pdf> (“[W]e support the Commission's proposal to amend Rule 14a-8(i)(8) to permit companies and their shareholders to formulate rules appropriate to them for shareholder access to the company's proxy statement for the purpose of nominating directors.”). *Compare* Letter from Christine P. Richards, Executive Vice President, General Counsel & Sec'y, FedEx Corp., to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 1, 2007), available at <http://www.sec.gov/comments/s7-17-07/s71707-74.pdf> (“FedEx strongly supports . . . codify[ing] the Commission's existing position that stockholder proposals on proxy statement access for board nominations are categorically excludable under Rule 14a-8(i)(8).”), with Letter from Christine P. Richards, Executive Vice President, Gen. Counsel & Sec'y, FedEx Corp., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-269.pdf> (“Amending Rule 14a-8(i)(8) to allow proxy access shareholder proposals would . . . enable companies and their shareholders to tailor an access system to the unique needs of the individual company.”). *Compare* Letter from Sullivan & Cromwell, LLP, to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 2, 2007), available at <http://www.sec.gov/comments/s7-16-07/s71607-458.pdf> (“[W]e strongly advocate the adoption of [the proposal] excluding director related nominations under Rule 14a-8(i)(8) . . . Rule 14a-8 varies in many very fundamental ways from state corporate law principles with respect to the making of shareholder proposals.”), with Letter from Sullivan & Cromwell, LLP, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-430.pdf> (“We believe that the Commission can accomplish its

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pass.⁹⁹ As such, corporations and law firms are arguing for the passage of Rule 14a-8(i)(8) *instead of* Rule 14a-11 precisely because Rule 14a-8(i)(8) can be tailored to each situation in a company. Presumably, company management feels that since amendments to Rule 14a-8(i)(8) would result only in process-driven changes instead of outcome-driven changes, changes to Rule 14a-8(i)(8) would still allow management to have a say in those processes in way that an outcome-driven rule would not. In short, allowing for shareholder ballots that change a company's structure does not *automatically* guarantee that the new structure will lead to a "shareholder friendly" board of directors. For this same reason, comments have been made (by people purporting to act on behalf of shareholders) vilifying the passage of Rule 14a-8(i)(8).¹⁰⁰

While the proponents' logic is plausible, it is also shortsighted. Although the flexibility of Rule 14a-8(i)(8) can potentially be used by company management to delay efforts for a more shareholder-friendly regime, in the long run there is much power behind the rule. The power of the process cannot be underestimated. Too often people focus on the end without giving due attention to the means. Yet, it is often the means that can result in the longest lasting impact. While allowing rules to focus on process is not necessarily the most glamorous way to conduct law, a cursory reminder of first-year civil procedure shows that the process can nonetheless have great effect—more effect even than the substantive outcome. As one commentator noted "one of the most obvious reasons for focusing on process is simply that many process issues are inherently important and needed to be resolved."¹⁰¹

CONCLUSION

It will take a few years to see how the effect of both Rules 14a-11 and 14a-8(i)(8) will play out on the proxy statements and in the boardrooms of corporate America. Perhaps in a few years' time, a study can be done to see what real effect (if any) the addition of these two shareholder-friendly rules have on producing more corporate accountability. Indeed, there are myriad factors that can affect the long-term participation of a stakeholder in their company.¹⁰² However, I am hopeful that allowing shareholders a say in the process of their company will lead to a sense of

objective of removing federal impediments to the development of proxy access simply be amending Rule 14a-8(i)(8) as proposed.").

99. On August 26, 2009, the *Wall Street Journal* published an article discussing the proxy access rules in general. According to the *Journal*, "most opponents expect [proposed Rule 14a-11] to pass." McCracken & Scannell, *supra* note 17.

100. See, e.g., Letter from Les Greenberg, Chairman, Comm. of Concerned S'holders, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (June 11, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-9.pdf> ("To enact rules with Director-nominating criteria that are unlikely to meet [sic], except in extremely rare circumstances, would be a travesty on the investing public.").

101. Martinez, *supra* note 86, at 1061. In addition, "social psychologists have shown that ordinary people are strongly influenced by their perceptions of procedural justice." *Id.* at 1062.

102. See Goforth, *supra* note 88, at 414 n.205 (citing several articles discussing barriers to shareholder participation).

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empowerment for long-term shareholders; for shareholders to feel that their voice will be a force for effecting change in the company with regard to corporate accountability. If that can be accomplished then the power of the process will indeed have been achieved and perhaps a future financial crisis, based on a lack of such accountability, can be avoided.

