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Public Company Update

D.C. District Court Rules Proxy Voting Advice Beyond The Scope Of Federal Proxy Rules

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On February 23, 2024, the U.S. District Court for the District of Columbia ruled in favor of Institutional Shareholder Services Inc. ("ISS"), a leading proxy advisory firm, on the party's motions for summary judgment, ending a years long dispute over whether proxy voting advice for a fee constitutes solicitation subject to the federal proxy rules, which are codified in the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The court held that the Securities and Exchange Commission (the "SEC") acted in excess of its statutory authority when it amended the proxy rules' definition of "solicit" and "solicitation" in 2020 to include proxy voting advice for a fee (the "2020 Rules").[1]

The landmark decision involves a prominent proxy advisory firm and an area of active rulemaking. Given the SEC's ongoing rulemakings briefly summarized below, the court ordered to stay this case multiple times. First, in August 2019, the SEC put forth an interpretation stating that "proxy voting advice constitutes a 'solicitation' under the federal proxy rules," and "Rule 14a-9 under the Exchange Act [applies] to proxy voting advice," thereby subjecting proxy advisory firms like ISS to the burdens of the proxy rules in the absence of an applicable exemption. Given the significant impact this guidance could have on its business model, in October 2019, ISS initiated this case against the SEC. By November 2019, the SEC released a proposed rule regarding the applicability of the proxy rules for proxy voting advice, doubling down on its interpretation, which were ultimately adopted in July 2020 (i.e., the 2020 Rules).[2] In November 2021, the SEC proposed another rule, cutting back on the 2020 Rules, which was adopted in July 2022.[3] Despite rolling back portions of the 2020 Rules, the 2022 final rule reaffirmed the SEC's position that proxy voting advice for a fee is a "solicitation" for purposes of the proxy rules. Please see our client alert for an in depth discussion of the 2020 Rules and their subsequent amendments in 2022.

[1] *See Institutional S'holder Servs. Inc. v. SEC*, No. 19-cv-3275 (APM), 2024 Us Dist Lexis 31012 (D.D.C. Feb. 23, 2024); Final rule: Exemptions from the Proxy Rules for Proxy Voting Advice, Securities and Exchange Commission, (July 22, 2020) https://www.sec.gov/rules/final/2020/34-89372.pdf.

[2] *See* Final rule: Exemptions from the Proxy Rules for Proxy Voting Advice, SECURITIES AND EXCHANGE COMMISSION, (July 22, 2020) https://www.sec.gov/rules/final/2020/34-89372.pdf.

[3] *See* Final rule: Proxy Voting Advice, SECURITIES AND EXCHANGE COMMISSION, (July 13, 2022) https://www.sec.gov/rules/final/2022/34-95266.pdf.

In reviewing the SEC's interpretations of its statutory authority to regulate proxy voting advice for a fee, the court followed the two-step framework set forth in *Chevron*.[4] Under the *Chevron* framework, the court must first implement congressional intent when the statutory language is clear with respect to the precise issue at hand using the tenants of statutory construction. Only if the statute in question is silent or ambiguous would the court then evaluate whether an agency's interpretations are entitled to deference.[5] Under *Chevron* step one, in evaluating the case, the court looked to the specific statutory language at issue. Notably, Congress did not define the term "solicit" in the proxy rules at adoption, leaving the parties to battle over the ordinary meaning of "solicit" and "solicitation" when Congress enacted the rules in 1934. The parties have varied interpretations of the historic dictionary definitions of "solicitation." Specifically, ISS contends that proxy advisory firms do not "solicit" proxies, as that term is used in Section 14(a) of the Exchange Act, because they do not seek proxy authority or ask shareholders to vote a certain way in order to achieve a particular outcome—they have no interest in the outcome of the vote. The SEC contends that the term "solicit" is inherently vague and reads the historic definitions more broadly. The SEC further argues that these definitions "do not necessarily imply an interest in obtaining a particular outcome, but rather focus on the nature and effect of the communication."[6] After reviewing the definitions in numerous dictionaries, the court ultimately sided with ISS and found the SEC's broader read, although acceptable, not reflecting the common usage of the terms.[7] The court also rejected the alternative definitions of "solicitation" offered by the Intervenor-Defendant National Association of Manufacturers ("NAM") that would encompass proxy voting advice for a fee.

Neither did the cases cited by the SEC unsettle the court's conclusion as *none* of these cases involved a communication by a disinterested individual.[8] The court also looked to the legislative history of Section 14(a) of the Exchange Act and ultimately concluded that the SEC's regulation of proxy voting advice as "solicitation" would not support the legislative purposes of the proxy rules— "to promote transparency and the exchange of complete and truthful information by and among interested parties seeking to obtain proxies in connection with a shareholder vote." The court further explained that by definition, proxy advisory firms are hired by a shareholder to provide *confidential* advice with respect to a corporate ballot measure.[9] Their advice is exclusively for the investors that hired them.[10] Thus, the risk that a proxy advisor's advice will deceive or mislead an ordinary, non-client shareholder is minimal.[11] The need for the SEC's oversight under Section 14(a) over proxy advisors is even further diminished by the prospect of tort liability and alternative causes of action.[12] The court is also not convinced by NAM's congressional acquiescence argument finding the evidence of congressional acquiescence scant.[13]

Ultimately, the court determined that the ordinary meaning of "solicit" in 1934 does not support proxy voting advice for a fee, thus resolving the definition-related claims at *Chevron* step one, without the need to proceed to *Chevron* step two. The court found that including proxy voting advice for a fee within the definition of "solicit" and "solicitation" is contrary to law and exceeds the SEC's statutory authority. According to the court, the definitional amendment codified in Rule14a-1(l)(1)(iii)(A) of the Exchange Act is vacated.

[4] *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).
[5] *See Chevron*, 467 U.S. at 843.
[6] *Id.* at *13.
[7] *See id.*
[8] *Id.* at *17.
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.* at *19.
[13] *Id.* at *19.

The decision has arguably altered the landscape of federal proxy regulation and may necessitate the SEC to reassess its approach in overseeing proxy guidance. As the landscape of corporate governance continues to evolve, the role of independent proxy advice will remain a focal point of debate among regulators, investors, and companies alike.

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