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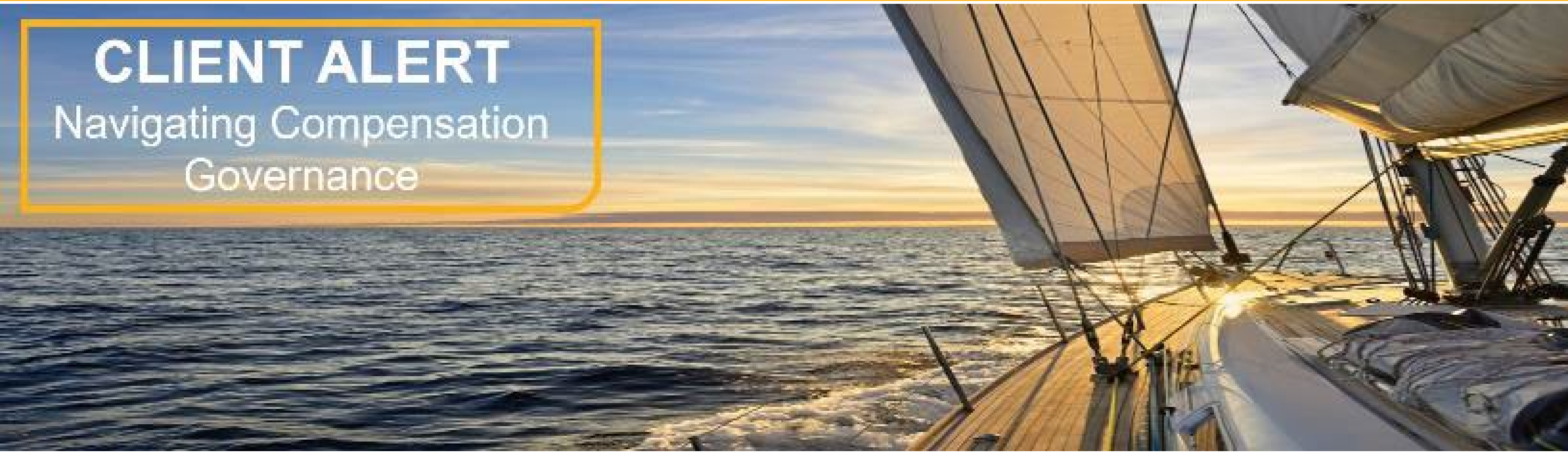

Federal Court Vacates SEC Rules Governing Proxy Voting Advice

Last month, a federal district court vacated the SEC's rule that would have regulated proxy advisory firms (PAFs).

The Court held that the SEC acted contrary to law and violated its statutory authority by amending the proxy rules' definition of "solicit" to include proxy voting advice for a fee. Institutional Shareholder Services (ISS) challenged the validity of the SEC rule and successfully argued that PAFs do not "solicit" proxies on behalf of their clients.

Background

Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act) makes it unlawful to "solicit" proxies "in contravention of such rules and regulations as the [Commission] may prescribe as necessary or appropriate in the public interest or for the protection of investors".

Between 2019 and 2022, the SEC issued guidance and adopted rules that interpreted the definition of "solicit" and "solicitation" to include the provision of proxy voting advice (i.e., vote recommendations) by PAFs to their clients. As a result, PAFs became subject to regulation by the SEC and certain information and filing requirements typically applicable to public companies. However, these information and filing requirements are not applicable to a PAF that discloses its conflicts procedures in accordance with SEC requirements.

Court Ruling

ISS filed a lawsuit in federal district court challenging the SEC's application of the proxy rules to proxy voting advice.

The case concerned whether PAFs "solicit" proxies within the meaning of Section 14(a) of the Exchange Act. ISS argued that PAFs do not "solicit" proxies, because PAFs do not ask shareholders to vote a certain way to achieve a particular outcome. The SEC claimed that PAFs "solicit" proxies because "solicit" also could mean "to move to action" or "to urge" or to "insist upon." The SEC argued that this broader meaning includes proxy voting advice provided by PAFs. Under the SEC's interpretation, "solicit" does not require a PAF to have an interest in obtaining a particular outcome.

The Court rejected the SEC's broader interpretation of the meaning of "solicit" and concluded that the *ordinary meaning* of the term did not encompass proxy voting advice in which PAFs are disinterested in the outcome of a proxy vote. Therefore, the Court found that the SEC exceeded its statutory authority by amending the proxy rules' definition of "solicit" to include the provision of proxy voting advice for a fee.

Meridian Comment: The Court's decision may not be the last word on the SEC's attempt to regulate PAFs. The SEC could appeal the Court's decision. In addition, other pending lawsuits seek to reinstate part of the SEC regulatory oversight of PAFs that the agency rescinded in 2022. In the meantime, PAFs need not comply with the SEC rules that the Court struck down.

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