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Proxy Advisers Win by a Nose, Eclipse Conflict Disclosure Requirement

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In February, a federal district judge in the District of Columbia awarded proxy advisers a victory by vacating an SEC rule provision that they opposed. Money managers (such as investment advisers, mutual funds, and pension funds) commonly retain proxy advisers to help decide how to vote shares of publicly held companies that are included in investment portfolios run by the money managers. Under the terms of the Securities Exchange Act of 1934 (Exchange Act), the SEC's proxy rules apply only to persons who "solicit" or participate in a "solicitation" of proxies to vote securities. The SEC, for many decades, has interpreted the concept of "soliciting" very broadly — broadly enough to encompass the activities of proxy advisory firms. But the SEC also historically allowed proxy advisory firms to avoid being covered by the proxy rules, subject to certain conditions that were not very burdensome. In recent decades, the SEC and other interested observers became increasingly concerned about the very significant and growing influence that proxy advisory firms were having on the shareholder voting process, as well as the manner in which proxy advisory firms were operating. To cut to the chase, the SEC adopted rule amendments in 2020 to specifically provide that proxy advisory firms were considered to be engaged in soliciting proxies and that they would be subject to the SEC's proxy rules unless they complied with certain conditions that were much more onerous than the historical conditions that had applied. Much jostling followed, and along the way, Institutional Shareholder Services Inc. (ISS) filed this suit challenging the SEC's revised positions. The National Association of Manufacturers (whose members include many publicly held companies) intervened in the suit as a co-defendant with the
SEC in support of its positions.

In response to the controversy, the SEC in 2022 adopted further amendments that removed all but one of the significant conditions that the SEC's 2020 amendments had imposed on proxy advisers. The one remaining condition was that a proxy adviser must disclose all conflicts of interest that are material to its objectivity. But ISS continued to press its case. In February of this year, the U.S. district judge granted summary judgment in favor of ISS. The judge held that the history and purpose of the

Exchange Act did not support the SEC's interpretation and that the ordinary meanings of "solicit" and "solicitation" when Congress enacted that statute did not encompass voting advice delivered by a person or firm (such as a proxy advisory firm) that has no interest in the outcome of the vote. The judge saw so little ambiguity on this point that he thought the question did not even satisfy the first prong of what is commonly known as the Chevron test, and it was therefore unnecessary even to consider deferring to the SEC's judgment on the matter. To the judge, then, this was not a closely run affair. On the other hand, it is unclear how significant this victory is for proxy advisers. ISS, for example, is a registered investment adviser. As such, it will continue to be subject to significant conflict of interest disclosure obligations under the Investment Advisers Act of 1940, including any further such requirements that the SEC may decide in the future to impose. For that and other reasons, proxy advisers may turn out merely to have nosed out the SEC temporarily with this summary judgment. Indeed, both the SEC and the National Association of Manufacturers have filed appeals to the district court's decision in this case.

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