

## **Securities Regulation Daily Wrap Up, PROXIES—Yale prof defends Harvard activist clinic against Gallagher paper, (Dec. 16, 2014)**

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By Anne Sherry, J.D.

A Yale University law professor has stepped in to challenge SEC Commissioner Daniel Gallagher's argument that the Harvard Shareholder Rights Project's destaggered board proposal violates securities laws. Jonathan R. Macey's post on a Harvard-hosted blog counters that the proposal is not fraudulent or misleading and points out the policy implications of threatening shareholders with enforcement actions over their proposals.

**Background.** Lucian Bebchuk's Shareholder Rights Project (SRP) has taken aim at classified boards, which force hostile bidders to engage in multiple proxy contests by staggering director reelections so that only one-third of board seats are up for election in any year, by submitting declassification proposals to large-cap companies. Last week, Commissioner Gallagher and former commissioner Joseph A. Grundfest, now with Stanford Law School, published a paper arguing that the SRP proposal cherry-picks from the academic research and can be excluded as materially false or misleading or even subject the university itself to antifraud liability.

**No antifraud violation.** Professor Macey argues that the SRP proposal does not contain a material omission, as it neither purports to contain a review of the academic literature nor suggests that contrary studies do not exist. He also points out that the 500-word limit under Rule 14a-8 would make it difficult for the SRP to include the kind of references and discussion envisioned by the Gallagher-Grundfest paper. Instead, the shareholder proposal should be viewed in the context of the larger proxy solicitation, where it will appear alongside management's contrary arguments and solicitation. In fact, Professor Macey states, Netflix's response to the SRP proposal, which Gallagher and Grundfest cited, listed only studies that support staggered boards. This suggests a double standard where shareholder proposals are expected to be completely self-contained while the company can respond with a one-sided presentation of the research, he wrote.

**Chilling effect on shareholder proposals.** Another point that Professor Macey raises concerns the policy rationale behind Rule 14a-8. He posits that the rule's purpose is to improve corporate governance by facilitating shareholder democracy. Accepting Gallagher and Grundfest's position that the SRP proposal is fraudulent would "have a major chilling effect on the ability of any shareholder to make a shareholder proposal without fear that such shareholder and its advisers will become the target of an SEC enforcement action and a defendant in private lawsuits." He also questions the inherent premise that the proposal would subject the SRP or Harvard University to antifraud liability, noting that he is unaware of any case or enforcement action taken against a shareholder proponent for fraud and that Gallagher and Grundfest do not cite one. "I am at a loss to imagine why the first such enforcement action ever to be taken would be lodged against proposals whose only alleged fault was not to include an additional reference to contrary studies," he writes.

**Internal tension at SEC.** The paper's real issue is not limited to the SRP proposals, Professor Macey writes, but extends to a criticism of SEC staff for taking a narrow view of no-action relief for companies that wish to exclude shareholder proposals on the basis of misrepresentations and omissions. Professor Macey questions the propriety of a sitting SEC commissioner's levying accusations at "an academic institution and a professor" as a means of effecting changes in enforcement practices at the agency. To this point, Gallagher and Grundfest would likely counter that Professor Bebchuk is not merely a professor, but also a shareholder activist who has caused the destaggering of nearly 100 corporate boards in the last three years. "There is no 'professor exemption' from the requirement that a proxy proposal not be materially false or misleading," their paper asserts.

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