

MEMO# 35765

July 9, 2024

Fifth Circuit Vacates Key Part of the SEC's 2022 Proxy Advice Amendments

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TO: ICI Members
Investment Company Directors
ESG Advisory Group
Investment Advisers Committee
Proxy Working Group
SEC Rules Committee
Small Funds Committee
SUBJECTS: Compliance
Fund Governance
Intermediary Oversight
Investment Advisers
Operations
Transfer Agency RE: Fifth Circuit Vacates Key Part of the SEC's 2022 Proxy Advice Amendments

On June 26th, the Fifth Circuit Court of Appeals vacated those 2022 SEC proxy advice amendments that rescinded the 2020 amendments—called the "notice-and-awareness" conditions—requiring proxy advisory firms to:

- Make their advice available to the companies that are the subject of the advice at or before the time that they make the advice available to clients (e.g., funds and investment advisers); and
- Provide their clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding the advice by companies.[\[1\]](#)

Summary of the SEC's 2020 and 2022 Proxy Advice Rulemaking

In 2020, the SEC adopted proxy advice amendments "so that investors who use proxy voting advice receive more transparent, accurate, and complete information on which to make their voting decisions, without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice."[\[2\]](#) The 2020 amendments:

- Codified the SEC's interpretation that proxy voting advice generally constitutes a "solicitation" within the meaning of the Exchange Act;
- Conditioned the availability of certain existing exemptions from federal proxy rule

requirements for proxy advisory firms (called "proxy voting advice businesses" in the proxy rules) (PVABs) upon compliance with additional disclosure and procedural requirements (including the notice-and-awareness conditions); and

- Amended the proxy antifraud rule to clarify when the failure to disclose certain information in proxy voting advice may be considered misleading.

In 2022, the SEC further revised these amendments.[\[3\]](#) Most notably, the 2022 amendments rescinded the 2020 notice-and-awareness conditions. The SEC stated that "we are no longer persuaded that the potential benefits of those conditions sufficiently justify the risks they pose to the cost, timeliness, and independence of proxy voting advice and believe that the final amendments strike a better policy balance."

As part of these 2022 amendments, the SEC also:

- Amended the proxy antifraud rule; and
- Rescinded its 2020 supplemental guidance to investment advisers about their proxy voting obligations.[\[4\]](#)

These 2022 amendments did not entirely unwind the 2020 amendments, however. Even following the 2022 amendments:

- Proxy voting advice remained a "solicitation" subject to the proxy rules.
- PVABs remained subject to the 2020 conflicts of interest disclosure requirements.

Summary of the District Court and Fifth Circuit Decisions

Following the 2022 rulemaking, National Association of Manufacturers and Natural Gas Services Group, Inc. filed suit against the SEC in a Texas district court. Plaintiffs brought claims under the Administrative Procedure Act (APA), arguing that the 2022 amendments were arbitrary and capricious because the SEC failed to:

- Provide an adequate justification for contradicting its prior factual finding that the 2020 amendments did not threaten the timeliness and independence of proxy voting advice; and
- Justify the 2022 amendments on their own terms.

The district court rejected plaintiffs' arguments and granted the SEC summary judgment.

On appeal, the Fifth Circuit reversed the district court's judgment, vacated those 2022 amendments that rescinded the 2020 notice-and-awareness conditions, and remanded to the SEC. The court found that the SEC acted arbitrarily and capriciously because it failed to:

- Adequately explain its decision to disregard its prior 2020 factual finding that the notice-and-awareness conditions posed little or no risk to the timeliness and independence of proxy voting advice; and
- Provide a reasonable explanation why these risks (i.e., with respect to timeliness and independence) were so significant under the 2020 amendments as to justify their rescission.

However, the Fifth Circuit did not vacate all portions of the 2022 amendments—it found that those not related to the notice-and-awareness conditions were severable. Therefore, the 2022 amendment to the proxy antifraud rule remains, as does the 2022 rescission of the 2020 supplemental guidance to investment advisers.

Additional Ongoing Litigation

The ultimate policy outcome (i.e., which portions, if any, of the 2020 or 2022 proxy advice rules survive) will depend on continued litigation, here (if the SEC chooses to appeal) and elsewhere.

In separate litigation dating back to 2019, proxy advisory firm Institutional Shareholder Services, Inc. (ISS) challenged the SEC's ability to regulate proxy voting advice as a "solicitation" under the Exchange Act. Earlier this year, the US District Court for the District of Columbia ruled in favor of ISS, holding that "the SEC acted contrary to law and in excess of statutory authority when it amended the proxy rules' definition of 'solicit' and 'solicitation' to include proxy voting advice for a fee."^[5] The SEC is appealing to the D.C. Circuit Court of Appeals.

Finally, the Chamber of Commerce and others challenged the SEC's 2022 rulemaking in Tennessee district court. That court ruled for the SEC,^[6] and the Chamber is appealing to the Sixth Circuit Court of Appeals.

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Notes

^[1] National Association of Manufacturers v. SEC, No. 22-51069 (5th Cir. June 26, 2024), available at <https://www.ca5.uscourts.gov/opinions/pub/22/22-51069-CV0.pdf>.

^[2] Exemptions from the Proxy Rules for Proxy Voting Advice, SEC Release No. 34-89372 (July 22, 2020) at 1, available at www.sec.gov/rules/final/2020/34-89372.pdf. For a more detailed summary of the 2020 amendments, see Institute Memorandum No. 32636, dated July 24, 2020.

^[3] Proxy Voting Advice, SEC Release Nos. 34-95266; IA-6068 (July 13, 2022), available at www.sec.gov/rules/final/2022/34-95266.pdf.

^[4] Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, SEC Release No. IA-5547 (July 22, 2020), available at www.sec.gov/rules/policy/2020/ia-5547.pdf.

^[5] Institutional Shareholder Services., Inc. v. SEC, No. 19-CV-3275 (APM) (D.D.C. Feb. 23, 2024).

^[6] Chamber of Commerce of the United States of America et al v. SEC et al, No. 3:2022cv00561 (M.D. Tenn. Apr. 24, 2023).