



Volume 1 | Issue 1

Article 3

1999

Commentary on a Rare Luddite Victory - The Templeton Dragon Fund Shareholder Proposal No-Action Letter

Howard M. Friedman

Follow this and additional works at: <https://digitalcommons.law.villanova.edu/vjlim>

 Part of the [Banking and Finance Law Commons](#), and the [Secured Transactions Commons](#)

Recommended Citation

Howard M. Friedman, *Commentary on a Rare Luddite Victory - The Templeton Dragon Fund Shareholder Proposal No-Action Letter*, 1 Vill. J.L. & Investment. Mgmt. 41 (1999).

Available at: <https://digitalcommons.law.villanova.edu/vjlim/vol1/iss1/3>

This Article is brought to you for free and open access by Villanova University Charles Widger School of Law Digital Repository. It has been accepted for inclusion in Villanova Journal of Law and Investment Management by an authorized editor of Villanova University Charles Widger School of Law Digital Repository.

Commentary on a Rare Luddite Victory — The Templeton Dragon Fund Shareholder Proposal No-Action Letter

Howard M. Friedman*

Securities and Exchange Commission (SEC) no-action letters have been described by the United States Court of Appeals for the Second Circuit as “non-binding statements of the SEC’s intent not to prosecute a potential rule violation.”¹ Formally they have no binding effect even on the parties to whom the letter is issued.² Nevertheless, lawyers have come to rely on SEC no-action letters for guidance in interpreting federal securities laws.³ Several developments explain the increasing importance of no-action letters. First, on-line services such as LEXIS and Westlaw have made no-action letters more accessible. Second, the body of securities case law that is available for guidance is diminishing as the courts and Congress narrow private rights of action. Third, more disputes are resolved through arbitration, resulting in unwritten opinions. Therefore, the rare no-action letter that appears to depart radically from more formal SEC pronouncements deserves attention.⁴

* Professor of Law, University of Toledo College of Law. Professor Friedman is author of *SECURITIES REGULATION IN CYBERSPACE* (2d ed., 1998).

¹ *New York City Employees’ Retirement Sys. v. SEC*, 45 F.3d 7, 13 (2d Cir. 1995) (citing *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257 (2d Cir. 1994)).

² See *Amalgamated Clothing*, 15 F.3d at 257 (noting that SEC no-action letter does not fix any legal relationship between parties).

³ See Thomas P. Lemke, *The SEC No-Action Letter Process*, 42 *BUS. LAW.* 1019 (1987) (noting that no-action process is chief mechanism “permitting the public and practitioners to obtain the informal views of the SEC staff on proposed transactions that appear to raise compliance issues under applicable federal securities laws and the rules thereunder”); Richard H. Rowe, *A SEC Staff “No-Action” Position: An Impervious Shield Against Liability or a Paper Tiger?*, 6 *INSIGHTS* 21 (July 1992).

⁴ For judicial discussion of another example of a no-action letter that departed from a formal SEC pronouncement, see *New York City*

42 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

The June 1998 *Templeton Dragon Fund* no-action letter⁵ may be unique in departing radically from two separate lines of formal Commission interpretations without acknowledging either departure. Particularly since 1995, the SEC has been in the forefront of those encouraging innovative uses of Internet technology to disseminate information to investors.⁶ In both letter and spirit, *Templeton Dragon Fund* reverses course. Moreover, in 1992, the SEC adopted extensive amendments to its proxy rules to encourage more communication among shareholders who were not actually seeking authority to vote the shares of others. It did this by deregulating a good deal of speech among investors who were not themselves seeking proxy authority. No longer was every communication that related to matters on an upcoming meeting agenda to be screened in advance by the SEC. The requirement to speak only through a formal proxy statement was to be applied more selectively.⁷ *Templeton Dragon Fund* also repudiates an important application of these 1992 liberalizations.

Employees' Retirement Sys. v. SEC, 45 F.3d 7 (2d Cir. 1995) (holding that no-action letter was interpretive, not legislative, and thus not subject to notice and comment procedures, and was reviewable as arbitrary or capricious agency action only through a suit against the issuer).

⁵ *Templeton Dragon Fund, Inc.*, SEC No-Action Letter, 1998 WL 337469 (June 15, 1998) [hereinafter *Templeton Dragon Fund*].

⁶ The two major SEC releases that initiated the SEC's pro-technology stance were Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7,233, 1 Fed. Sec. L. Rep. (CCH) ¶ 3,200 (Oct. 6, 1995) and Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers for Delivery of Information, Securities Act Release No. 7,288, 1 Fed. Sec. L. Rep. (CCH) ¶ 3,201 (May 9, 1996). See generally HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE (2d ed., 1998).

⁷ See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Oct. 16, 1992) (noting that new rules remove "unnecessary government interference in discussions among shareholders of corporate performance").

I. BACKGROUND OF TEMPLETON DRAGON FUND

The SEC's shareholder proposal rule, Rule 14a-8, embodies finely tuned compromises between the interests of management and those of shareholders.⁸ If a shareholder who has not solicited its own proxies must first introduce a proposal that management opposes from the floor of the shareholders' meeting, the proposal will surely be defeated. Management will hold sufficient proxies, with discretionary authority to vote on proposals raised for the first time at the meeting, to defeat any such proposal.⁹ Even so, it is typically cost-prohibitive for a small shareholder to solicit its own proxies in order to obtain passage of a resolution at the shareholders' meeting of a publicly-held company. Therefore, for many years, Rule 14a-8 has permitted a shareholder to submit a proposal to management that the shareholder wishes to place before fellow investors at the company's annual meeting, along with a statement in support of the proposal.¹⁰ The shareholder proposal and supporting

⁸ See Securities Exchange Act of 1934 Rule 14a-8, 63 Fed. Reg. 29,118, 29,119 (1998) (to be codified at 17 C.F.R. § 240.14a-8) (providing new rule for shareholder proposals). For a discussion of the many factors that are involved, see Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 19,135, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,262 (Oct. 14, 1982).

⁹ Securities Exchange Act of 1934 Rule 14a-4(c), 63 Fed. Reg. 29,118, 29,119 (1998) (to be codified at 17 C.F.R. § 240.14a-4(c)) (permitting management to obtain in its proxy discretionary authority to vote on matters that are raised at meeting without advance notice to management). Even where management has been notified in advance, if the proponent is not soliciting its own proxies and is not making use of Rule 14a-8, management may seek discretionary authority so long as it discloses how it intends to exercise its discretion.

¹⁰ The first shareholder proposal rule was adopted in 1942. See Part 240 — General Rules and Regulations, Securities Exchange Act of 1934, 7 Fed. Reg. 10,655, 10,656 (Dec. 21, 1942) (formalizing earlier interpretations of Commission). See Arthur H. Dean, *Non-Compliance With Proxy Regulations: Effect On Ability of Corporation To Hold Valid Meeting*, 24 CORNELL L.Q. 483, 497-506 (1939) (discussing proxy regulations relating to shareholder proposals and problems confronting management). For a history of the rule's development, see IV SECURITIES REGULATION 1998-2052 (Louis Loss & Joel Seligman, 3d ed. 1990); Donald E. Schwartz & Elliott J. Weiss, *An Assessment of the SEC Shareholder Proposal Rule*, 65 GEO. L.J. 635, 654-57 (1977) (providing history of Rule 14a-8).

44 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

statement together may not exceed 500 words. Management may object to inclusion of the shareholder proposal and supporting statement in its proxy materials on several grounds set forth in Rule 14a-8(i).¹¹ In such a case the SEC staff issues a letter in which the staff either agrees or disagrees with management's contention that the shareholder proposal may be excluded.¹²

The *Templeton Dragon Fund* letter involved an attempt by Newgate LLP, a shareholder in the Fund, to place its shareholder resolution in Templeton Dragon Fund's proxy statement. Underlying the letter is a broader movement by shareholders of closed-end mutual funds to force management to convert their funds to open-end investment companies.¹³ Closed-end funds often sell at a discount from their net asset value while the price of open-

¹¹ Securities Exchange Act of 1934 Rule 14a-8(i), 63 Fed. Reg. 29,118, 29,120 (1998) (to be codified at 17 C.F.R. § 240.14a-8(i)). According to the rule, there are 13 grounds for omitting a shareholder proposal and supporting statement from the proxy. See *id.*

¹² Under Rule 14a-8, if a shareholder submits a proposal that the company proposes to exclude, the company must submit its reasons and a supporting opinion of counsel to the SEC no later than 80 calendar days before it files its definitive proxy statement. See Securities Exchange Act of 1934 Rule 14a-8(j), 63 Fed. Reg. 29,118, 29,120 (1998) (to be codified at 17 C.F.R. § 240.14a-8(j)). It must at the same time furnish the shareholder with a copy of its submission. See *id.* The shareholder is permitted, but not required, to file a response. Securities Exchange Act of 1934 Rule 14a-8(k), 63 Fed. Reg. 29,118, 29,120 (1998) (to be codified at 17 C.F.R. § 240.14a-8(k)). After considering this material, the staff of the SEC will write to the company either agreeing or disagreeing with its assertion that the proposal may be excluded. Sometimes the staff takes the position that the proposal must be included only if the shareholder proponent makes specified revisions to it. Securities Exchange Act of 1934 Rule 14a-8(m)(3)(i), 63 Fed. Reg. 29,118, 29,121 (1998) (to be codified at 17 C.F.R. § 240.14a-8(m)(3)(i)). At the time of the *Templeton Dragon Fund* no-action letter, similar provisions appeared in Securities Exchange Act of 1934 Rules 14a-8(d)-(e), 17 C.F.R. § 240.14a-8(d)-(e) (1998).

¹³ See Carol Carangelo, *SEC Clears Hurdle for Closed-End Fund Shareholders*, FUND DIRECTIONS, June 1998, at 2; Carole Gould, *How a Closed-End Fund Aims to Tame Its Discount*, N.Y. TIMES, June 28, 1998, § 3, at 8; Eric Rosenbaum, *Mercury Closed-End Fund Lowers Open-Ending Hurdle*, FUND ACTION, Aug. 10, 1998, at 1, 12.

(VOL. 1:41 1999) COMMENTARY ON A RARE LUDDITE VICTORY 45

end funds reflects no similar discount.¹⁴ Therefore, opening a closed-end fund results in an instant increase in value for existing shareholders. Despite this, managers of closed-end funds have resisted change, often arguing that opening the fund would have other negative impacts.

In March 1998, Newgate, which owned over 1.8 million shares of Templeton Dragon Fund, notified Fund management that it planned to introduce a resolution at the 1998 annual meeting recommending that the Fund's directors take all necessary action to convert from closed-end to open-end status. Invoking Rule 14a-8, Newgate requested that its resolution, along with a supporting statement, be included in the Fund's proxy statement that would be sent to shareholders. Newgate attempted to alleviate the problem posed by the 500 word limitation through the use of new technology. The supporting statement began as follows:

We are limited by Federal law to a 500 word statement. Accordingly, we hope that shareholders will carefully review the 4 points set forth below. Additional historical performance data on this Fund can be accessed on Newgate's Internet site at newgateglobal.com.¹⁵

Fund management objected to including the proposal in the Fund's proxy statement. In particular, it objected to the reference to Newgate's Internet Web site. Three separate objections were made. The most straight forward was that reference to the Web site would subvert "the intent of the 500 word limit of paragraph (b)(1)." According to management, making additional information available in this way would circumvent "the spirit, if not the letter" of Rule 14a-8's limitation on the length of shareholder proposals and accompanying supporting statements.

A second objection focused on the impermanent nature of information on a Web site. Because Newgate might

¹⁴ For discussion of discounts in closed-end funds, see *The Internet Closed-End Fund Investor, A Deeper Look at Discount/Premium* (visited Oct. 22, 1998) <http://www.icefi.com/icefi/tutorial/anal_dis.htm>.

¹⁵ *Templeton Dragon Fund*, *supra* note 5, at *1.

46 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

continually change the content of its Web site, it would not be able to furnish the SEC with a copy of the information that would be on the site in the future. This meant that potentially false and misleading information on the site would not be subject to SEC staff review. In addition, management asserted, that it would not be able to readily respond to changing information on Newgate's Web site without the considerable cost of preparing, filing and mailing supplemental proxy materials to its shareholders. This, management argued, "subverts the proxy process."¹⁶

A third objection was that the historical performance data that Newgate claimed was on its Web site in fact was not available there and had not been otherwise furnished to the Fund. This, it was argued, made the reference to Newgate's Web site misleading.

In a typically cryptic no-action letter, the SEC's Division of Corporation Finance agreed with the Fund that "[t]here is support for your view that the reference to Proponent's internet site in the supporting statement potentially may violate the proxy process requirements of paragraph (b)(1) of the Rule" and therefore the reference could be omitted from the Fund's proxy statement.¹⁷ This language in the no-action letter left unclear whether the staff agreed with all, or only some, of the arguments made by the Fund, since paragraph (b)(1) of Rule 14a-8 was the provision in the Rule that both limited the length of the shareholder proposal and supporting statement to 500 words and required the supporting statement to be furnished to the issuer at the same time as the shareholder proposal itself was furnished.¹⁸

¹⁶ *Templeton Dragon Fund*, *supra* note 5, at *2.

¹⁷ *Templeton Dragon Fund*, *supra* note 5, at *7.

¹⁸ See Securities Exchange Act of 1934 Rule 14a-8(b)(1), 17 C.F.R. § 240.14a-8(b)(1) (1998). On May 28, 1998, Rule 14a-8 was amended. The 500 word limitation of paragraph (b)(1) now appears in paragraph (d). See Securities Exchange Act of 1934 Rule 14a-8(d), 63 Fed. Reg. 29,118, 29,119 (1998) (to be codified at 17 C.F.R. § 240.14a-8(d)).

II. THE USE OF THE INTERNET IN PROXY SOLICITATIONS

Since 1995, the Internet has become an increasingly important tool in proxy solicitations. For uncontested meetings, companies increasingly post their proxy statements and annual reports to shareholders on their Web sites, delivering these documents electronically and permitting proxies to be returned via the Internet.¹⁹ In proxy contests, the Internet is beginning to be used as a supplement to the proxy statement to furnish more information to interested shareholders.²⁰ For example, in their 1996 challenge to the management of RJR Nabisco, Carl Icahn and Bennett Lebow posted follow-up information on the Web site of Georgeson & Co., their professional proxy soliciting firm.²¹ Where dissidents have already sent out a proxy statement, this kind of additional soliciting material does not need to be pre-cleared by the SEC. It must merely be filed with the SEC and the relevant stock exchanges on the date that it is first made available to shareholders.²²

Just as a Web site seems an appropriate vehicle for supplementing dissidents' arguments in a proxy fight, it seems similarly well suited for supplementing the bare-bones 500 word (or less) statement in support of a shareholder's proposal under Rule 14a-8. Indeed, nothing in the SEC's *Templeton Dragon Fund* no-action letter precludes shareholder proponents from placing additional information on a Web site. The no-action letter merely prevents the shareholder from calling the Web site to fellow-shareholders' attention through management's proxy statement. In reaching that result, the arguments accepted by the SEC seem surprisingly unpersuasive.

¹⁹ See FRIEDMAN, *supra* note 6, at ch. 11.

²⁰ See FRIEDMAN, *supra* note 6, at ch. 12.

²¹ See Hal Lux, *Internet Becomes Tool In Nabisco Proxy Fight*, INV. DEALERS' DIGEST, Jan. 29, 1996, at 8 (discussing experiment with Internet in proxy fight and noting that while "the Web is not likely to be the deciding factor in [proxy] fight . . . proxy experts say it is a medium worth the experiment").

²² Securities Exchange Act of 1934 Rule 14a-6(b), 17 C.F.R. § 240.14a-6(b) (1998); see FRIEDMAN, *supra* note 6, § 12.01[b].

III. WHY THE SEC WAS WRONG

A. 500 WORD LIMITATION

The simplest argument put forward by management was that the shareholder's Web site violated the 500 word limitation for shareholder proposals in Rule 14a-8. This deceptively literal conclusion fails to address the policies behind Rule 14a-8's 500 word limitation. While the SEC has not always spelled out the rationale for its long-standing limitation on the length of shareholder proposals and/or supporting statements,²³ the least persuasive explanation is that the government has determined that shareholder proponents should not speak at length. In the past, when government has attempted — usually unsuccessfully — to restrict the quantity of speech, its goal has been to equalize the relative ability of competing sides to reach an audience.²⁴ That cannot be the SEC's

²³ The exact limitation has varied over time. Early versions of Rule 14a-8 contained only a limitation on the length of the supporting statement. The earliest version (then numbered Rule 14a-7) merely limited supporting statements to 100 words. *See Part 240 — General Rules and Regulations, Securities Exchange Act of 1934*, 7 Fed. Reg. 10,655, 10,656 (Dec. 21, 1942). When that limitation began to be abused through the use of lengthy "Whereas clauses" in the proposal which were in fact arguments for adoption of the proposal, the Commission amended Rule 14a-8 to provide that these clauses would be counted as part of the supporting statement, but raised the word limit for the supporting statement to 200 words. *See Adoption of Amendments to Rules 14a-5 and 14a-8 under the Exchange Act, Exchange Act Release No. 9,784*, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,997 (Sept. 22, 1972). In 1976, the Commission added a separate 300 word limitation for the shareholder proposal itself. *See Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,812 (Nov. 22, 1976) (noting that 300 word limitation was due in part to several proposals that "exceeded the bounds of reasonableness"). In 1983, these were combined into a 500 word limit for the proposal and supporting statement together. *See Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20,091*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,417 (Aug. 16, 1983).

²⁴ *See Buckley v. Valeo*, 424 U.S. 1, 48-49 (1976) (holding that "the concept that government may restrict the speech of some elements of

(VOL. 1:41 1999) COMMENTARY ON A RARE LUDDITE VICTORY 49

goal here since management has no limits imposed on the length of the counter-arguments that it places in its proxy statement. Indeed, the SEC's entire attempt to restore shareholder democracy has been a battle *against* the voicelessness of the small shareholder. Rule 14a-8 was an attempt to give the small shareholder some power, not to limit his or her voice.²⁵

A different rationale is suggested by the administrative history of Rule 14a-8 and seems more persuasive. In its 1976 amendments to Rule 14a-8 that, for the first time, imposed length restrictions on the shareholder's resolution itself, as well as on the supporting statement, the SEC noted:

[I]n recent years several proponents have exceeded the bounds of reasonableness . . . by submitting proposals that are extreme in their length. Such practices are inappropriate under Rule 14a-8 not only because they constitute an unreasonable exercise of the right to submit proposals at the expense of other shareholders but also because they tend to obscure other material matters in the proxy statements of issuers, thereby reducing the effectiveness of such documents.²⁶

Stated more fully, since Rule 14a-8 forces management to include unwanted material in its proxy statement, Rule 14a-8 is designed to limit the burden and costs imposed on management and other shareholders. A 500 word

our society in order to enhance the relative voice of others is wholly foreign to the First Amendment . . ."); *see also* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 789-92 (1978) (same). *Cf.* Austin v. Michigan Chamber of Commerce, 494 U.S. 652, 658-60 (1990) (upholding prohibition on corporate expenditures to support or oppose candidate on ground that restriction "ensures that expenditures reflect actual public support for the political ideas espoused by corporations").

²⁵ *See* Donald E. Schwartz & Elliott J. Weiss, *An Assessment of the SEC Shareholder Proposal Rule*, 65 GEO. L.J. 635, 638-48 (1977) (discussing costs and benefits of Rule 14a-8).

²⁶ *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,812, at 87,127 (Nov. 22, 1976).

50 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

statement adds little in printing or postage costs to the corporation's mailing. On the other hand, permitting an unlimited amount of material to be included at corporate expense could create a substantial burden. The length limitation also avoids deflecting attention from management's basic message. A very lengthy discussion of a shareholder proposal might overwhelm other — and to management, more important — issues discussed in the proxy statement. By limiting the length of shareholder proposals, Rule 14a-8 still permits management to focus the attention of shareholders on the other issues it wishes to bring to a vote. Neither the goal of avoiding new costs nor of assuring appropriate focus on other items is undercut by permitting the shareholder proponent to include in his or her 500 word statement a reference to a Web site.²⁷

B. PRIOR REVIEW

Fund management also argued that the impermanent nature of information of a Web site would preclude prior review by the SEC staff of potentially false and misleading information. The SEC, however, has disclaimed any interest in being able to review such communications in advance. In fact, the SEC has put forward a wide range of initiatives in recent years to lessen its role as censor of materials sent out to shareholders in connection with shareholder meetings. In 1992, the SEC adopted major amendments to its proxy rules that were designed to eliminate much of the SEC's previous role as censor of speech relating to upcoming meetings.²⁸ Proxy statements

²⁷ It might be thought that while the goal of Rule 14a-8 is not to place an absolute limit on shareholder argumentation, perhaps its goal is to limit speech unless a shareholder proponent first files a full proxy statement with the SEC. In that way, the SEC would have the opportunity to review the accuracy of long arguments. This argument for prior review is no more persuasive than the argument for prior review made by Fund management, which is discussed below.

²⁸ See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Oct. 16, 1992) (noting that amendments to rules "eliminate

(VOL. 1:41 1999) COMMENTARY ON A RARE LUDDITE VICTORY 51

for routine meetings no longer have to be filed in advance for SEC review.²⁹ Management merely needs to file a definitive copy of the proxy statement when it sends the proxy statement to shareholders. Even in mergers and contested elections where proxy statements do need to be filed in advance, additional soliciting material only needs to be filed at the same time that it is sent to shareholders.³⁰ Thus no advance review is mandated for material placed on a Web site after a proxy statement is mailed, even in proxy contests. In adopting amendments eliminating the advance filing of most proxy material, the SEC observed:

The Commission believes that the most cost-effective means to address hyperbole and other claims and opinions viewed as objectionable is not government screening of the contentions or resort to the courts. Rather, the parties should be free to reply to the statements in a timely and cost-effective manner, challenging the basis for the claims and countering with their own views on the subject matter through the dissemination of additional soliciting material.³¹

More importantly, the 1992 amendments deregulated much speech relating to upcoming shareholder meetings where the speaker is not actually soliciting proxy authority and does not otherwise, because of a substantial interest in the matter being voted upon, stand to receive a benefit that will not be shared pro rata by all other holders of the

unnecessary regulatory obstacles"). In explaining the new rules, the SEC stated, "The amendments adopted today reflect a Commission determination that the federal proxy rules have created unnecessary regulatory impediments to communication among shareholders and others and to the effective use of shareholder voting rights." *Id.* at 83,355.

²⁹ Securities Exchange Act of 1934 Rule 14a-6(a), 17 C.F.R. § 240.14a-6(a) (1998) (providing filing requirements of preliminary proxy statements).

³⁰ Securities Exchange Act of 1934 Rule 14a-6(b), 17 C.F.R. § 240.14a-6(b) (1998).

³¹ Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051, at 83,365 (Oct. 16, 1992).

52 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

same class of securities.³² In such cases, no proxy statement needs to be filed or distributed. In its Release adopting these rules, the SEC stated explicitly that sponsorship of a Rule 14a-8 shareholder proposal does not create a substantial interest that would preclude the proponent from freely communicating with other shareholders, unless there is something special about the content of the proposal that creates a substantial interest. The mere fact of inclusion of the proposal does not create such an interest.³³

C. BURDEN OF RESPONSE

A subsidiary part of Templeton management's argument was that it would not be able to readily respond to changed information on the shareholder's Web site without costly preparation, filing and mailing of supplemental proxy materials to its shareholders. This ignores the fact that Templeton need not use "snail mail" to respond to proponent's cyberspace message. A response through Templeton's own Web site would be speedier, less costly and probably more effective when management is countering other Internet-based speech. Anyone with sufficient computer knowledge to access Newgate's Web site could in turn easily access Templeton's.

³² Securities Exchange Act of 1934 Rule 14a-2(b)(1), 17 C.F.R. § 240.14a-2(b)(1) (1998). The one exception is institutional investors which are required to file a Notice of Exempt Solicitation pursuant to Rule 14a-6(g) within three days of sending out material, to guard against secret solicitation campaigns by large shareholders. See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051, at 83,359 (Oct. 16, 1992).

³³ See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051, at 83,361 (Oct. 16, 1992).

IV. A NARROW BASIS FOR THE SEC'S DETERMINATION

While the major arguments put forward by Templeton Dragon Fund management and accepted by the SEC staff seem unpersuasive, the facts do give the staff an acceptable narrow ground for its conclusion. Interpreting the no-action letter in this way may save it from threatening future innovative approaches to promoting shareholder democracy. Newgate's supporting statement submitted for inclusion in the Fund's proxy statement specifically said that additional historical performance data on Templeton Dragon Fund was available at Newgate's Web site. In fact no such information had been placed on the Web site.

Rule 14a-8 permits management to exclude a shareholder proposal or supporting statement if its language is materially false or misleading.³⁴ This might well be an acceptable basis for permitting management to exclude Newgate's supporting statement, or at least for requiring Newgate to modify its statement to indicate merely that Newgate planned in the future to post additional material relating to the shareholder proposal on its Web page.

V. PROPOSED RULE CHANGES TO FACILITATE USE OF WEB SITES TO SUPPLEMENT SHAREHOLDER PROPOSALS

Despite my criticism of the SEC's willingness to permit the exclusion of Newgate's supporting statement, management of Templeton Dragon Fund did raise two objections that call for further examination and that suggest the need for new rule making.

³⁴ Securities Exchange Act of 1934 Rule 14a-8(i)(3), 63 Fed. Reg. 29,118, 29,120 (1998) (to be codified at 17 C.F.R. § 240.14a-8(i)(3)). At the time of the *Templeton Dragon Fund* no-action letter, these provisions appeared in Rule 14a-8(c)(3), 17 C.F.R. § 240.14a-8(c)(3) (1998).

A. REQUIRING MUTUAL HYPERLINKS

Templeton Dragon Fund's management was concerned about its ability to respond to ever-changing content on the proponent's Web site. As suggested above, a like-kind response, that is, one through management's own Web site, is an inexpensive and effective way to participate in an ongoing exchange of ideas with a shareholder proponent. A rule change would facilitate this kind of on-line interchange.

The SEC has a legitimate interest in making certain that shareholders have convenient opportunities to consider arguments on both sides of an issue. Therefore, it should consider mandating through Rule 14a-8 mutual hyperlinks between Web pages arguing both sides of an issue. If proponents set up a Web page to furnish additional information, they should be required to include on the page a prominent hyperlink to any management Web page that has been created to discuss management's side of the issue. Similarly, any management page discussing the issue should contain a hyperlink to the relevant page on the proponent's Web site.³⁵ Moreover, if management posts its proxy statement on the World Wide Web, proponent's textual reference to its Web site should also be a hypertext link to the site.

Mutual hyperlinks will not only assure that shareholders have ready access to both sides' arguments, they will also provide an easy method for each side to check on whether the other has recently changed the material on its Web site. Any new rule might go further and require each side to notify the other by e-mail when it makes a change to its Web site relating to the shareholder proposal. This addition, however, is probably unnecessary since it requires little effort to check the linked Web site regularly during the period between the mailing of the proxy statement and the convening of the annual meeting.

³⁵ The SEC should probably consider imposing a similar requirement when Web sites are used by opposing interests in any type of proxy solicitation.

(VOL. 1:41 1999) COMMENTARY ON A RARE LUDDITE VICTORY 55

A notification provision *would* call attention to minor changes that might go unnoticed through a routine check of the Web site. However, such a provision might also invite unnecessary disputes about whether timely notice was given. The rule mandating mutual hyperlinks needs to be limited to situations in which one side has notified the other of the existence of its Web site, and the SEC will need to stand ready to adjudicate disputes about inclusion of hyperlinks in the same way that it passes on other disputes under Rule 14a-8.

One other technical concern arises in implementing competing Web-based discussions. Under present Rule 14a-6(b), management (but not the Rule 14a-8 shareholder proponent) is required to file all of its additional soliciting material with the SEC.³⁶ This means that the material on management's Web site, and each changed version of the material, must be filed at the time it is first posted on management's server. As EDGAR is transformed to an Internet based system,³⁷ this will become a simple task. With little effort, management can save its Web page to a file and transmit that to the SEC electronically just as any other EDGAR document would be transmitted.

**B. PRIOR ON-LINE MISSTATEMENTS
AS A BASIS FOR EXCLUSION**

A second legitimate concern raised by Templeton Dragon Fund management is the added danger of false and misleading statements being disseminated when a proponent can constantly change the content of its Web

³⁶ The 1992 amendments eliminated the reciprocal obligation of non-management shareholders who were not actually seeking proxy authority to file soliciting material with the SEC in order to encourage free discussion among shareholders of matters on an upcoming shareholder meeting agenda. *See supra* notes 24-29 and accompanying text.

³⁷ For discussion of the conversion of the SEC's Electronic Data Gathering, Analysis and Retrieval system (EDGAR) to an Internet-based system, *see SEC Awards EDGAR Modernization Contract*, 30 SEC. REG. & L. REP. (BNA) 1016 (July 3, 1998); FRIEDMAN, *supra* note 6, § 15.04.

56 VILLANOVA JOURNAL OF LAW AND INVESTMENT MANAGEMENT

site. The danger of misleading argumentation through constantly changing content is not unique to Web sites. Telephone calls and individual e-mail communications during the proxy process pose similar issues. However, the broader reach of statements on a Web site, and other widely disseminated on-line messages, creates special risks of influencing votes through false or exaggerated claims. Particularly when new content is disseminated shortly before a shareholders' meeting, there may not be an effective opportunity for rebuttal. Relegating management to seeking remedial relief through litigation under Rule 14a-9 may be an inadequate alternative. Therefore, I suggest an additional rule change to deal with the heightened threat of false and misleading information that is introduced late in the proxy process.

Few shareholder proposals in fact succeed.³⁸ Often the goal of proponents is merely to obtain sufficient votes in favor of their proposal so that it can be resubmitted the following year. The strong message of such a vote may lead to successful negotiations or voluntary action by management on the subject matter of the proposal.³⁹ Under Rule 14a-8(i)(12), depending on how often the proposal has been included during the last five years, the proponent must obtain from 3% to 10% of the votes cast to include it the following year. An amendment to Rule 14a-8 should provide that an additional basis for excluding a shareholder proposal is that the proponent, during the past five years, included materially false or misleading information relating to a prior shareholder proposal on a Web site or in other broadly disseminated Internet communications. In addition to information on the proponent's Web site, the exclusion would apply to

³⁸ See Robert Todd Lang et al., *Shareholder Initiatives: Proposals and Solicitations*, 4 SECURITIES LAW TECHNIQUES § 53.06[1][a] (A.A. Sommer, Jr., ed., 1998) (noting that in 1993, only nine shareholder proposals passed).

³⁹ See *id.* § 53.02[1][b], at 36-37; § 53.06[1][a], at 31-32 (noting that willingness of management to address shareholder concerns depends on extent to which management believes shareholder can mobilize larger number of shareholders for future action).

(VOL. 1:41 1999) COMMENTARY ON A RARE LUDDITE VICTORY 57

materially false or misleading information that the proponent disseminated through such means as group e-mail messages, Internet bulletin boards or on-line chat rooms.

Such an additional basis for exclusion will not cast the SEC in any dramatically different role than it now assumes in passing on whether management may exclude a shareholder proposal. Currently one basis for management's exclusion of a proposal is that the proposal or supporting statement is materially false or misleading in violation of Rule 14a-9.⁴⁰ Also if the shareholder proponent believes that management's statements in opposition to the proposal violate rule 14a-9, the SEC's rule encourages the shareholder to promptly notify the Commission staff.⁴¹

VI. CONCLUSION

New technology creates possibilities for improving disclosure, increasing shareholder protection, promoting capital formation and furthering shareholder democracy. Innovative uses of technology require nurturing. Nipping them in the bud through reflexive literalism or in response to pleas of corporate management that are not justified in terms of broader regulatory policy discourages the experimentation which the SEC has so carefully nourished since 1995. Hopefully, the *Templeton Dragon Fund* no-action letter will come to be seen as a too-hasty response and will in fact lack precedential authority as no-action letters are supposed to do. Better yet, the Commission should formally repudiate the narrow and stilted interpretation of Rule 14a-8 reflected in *Templeton Dragon Fund*.

⁴⁰ Securities Exchange Act of 1934 Rule 14a-8(i)(3), 63 Fed. Reg. 29,118, 29,120 (1998) (to be codified at 17 C.F.R. § 240.14a-8(i)(3)).

⁴¹ Securities Exchange Act of 1934 Rule 14a-8(m)(2), 63 Fed. Reg. 29,118, 29,121 (1998) (to be codified at 17 C.F.R. § 240.14a-8(m)(2)).

