05-2825-cv

United States Court of Appeals

for the

Second Circuit

AMERICAN FEDERATION OF STATE, COUNTY & MUNICIPAL EMPLOYEES, EMPLOYEES PENSION PLAN,

Plaintiff-Appellant,

-v-

AMERICAN INTERNATIONAL GROUP, INC.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF AMICUS CURIAE HARVARD LAW SCHOOL PROFESSORS
LUCIAN BEBCHUK
ALLEN FERRELL
REINIER KRAAKMAN
MARK ROE
GUHAN SUBRAMANIAN

IN SUPPORT OF APPELLANTS, FOR REVERSAL

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Interests of the *Amici*

Amici are professors at Harvard Law School. They file this brief in their individual, not institutional, capacities. Their teaching and research interests lie in the areas of corporate and securities law.

Introduction and Summary

The case in front of the court presents the question of whether public companies may exclude shareholder proposals concerning the governance arrangements regulating the nomination of director candidates. In particular, the question is whether American International Group, Inc. ("AIG") may exclude the proposal (the "Proposal") submitted by the AFSCME Employees Pension Plan (the "Plan"). We submit this brief to describe the important function that the shareholder proposal rule (the "Rule") serves in the corporate and securities area. We also submit this brief to explain why any reasonable interpretation of the Rule should not allow the exclusion of such proposals, and why permitting companies to exclude such proposals would undermine the policy goals that the Rule seeks to advance.

Amici do not all hold the same views as to the substantive merits of the Proposal and as to whether its passage would benefit AIG's shareholders. *Amici*, however, believe that the Rule requires AIG to allow

the Proposal to be brought to a shareholder vote and to enable shareholders to make for themselves the decision on the subject. AIG should not be allowed to deny shareholders the opportunity to do so by excluding the Proposal.

For the reasons discussed below, we respectfully urge this Court to reverse the district court's decision not to grant the Plaintiff's motion for a preliminary injunction.

The Benefits of Including Shareholder Proposals

In the United States, the legal rules regarding a corporation's internal corporate governance—the powers and responsibilities of shareholders, management and the board of directors—are established by state corporate law. State law provides shareholders with the power to amend bylaws and determines which bylaw amendments are valid.

A shareholder that would like to see a bylaw amendment pass could in theory solicit proxies from shareholders and file the proxy statement required in connection with such proxy solicitation. This option, however, is often prohibitively costly. Proxy solicitation involves significant costs, and the proposing shareholder would have to bear these costs but would capture at most some of the benefits from a bylaw amendment. Thus, without the

shareholder proposal rule ("the Rule"), shareholder power to propose bylaw amendments would be largely inconsequential.

This "collective action" problem is alleviated to some extent by the Rule. With certain exceptions we discuss below, the Rule requires a company to include the text of a shareholder proposal in the proxy statement provided to shareholders by management and to give shareholders the opportunity to vote for the proposal on management's proxy card. If the required majority votes in favor of a bylaw amendment, the amendment will be adopted.

Thus, the ability of shareholders to have proposals included in the company's proxy statement under the Rule is a critical element in making the corporate voting system work. Allowing companies would to exclude a given type of proposals would all but eliminate voting on such proposals. Expanding the ability of companies to exclude a given class of corporate governance proposals whose exclusion is not permitted by the Rule would thus have potentially severe consequences, making it practically very difficult if not impossible for shareholders to adopt such proposals.

The Election for Board Membership Exclusion

AIG argued, and the District Court erroneously accepted, that the AIG may exclude the Proposal as one that "relates to an election for membership on the company's board of directors." This exclusion provision should be understood as permitting the exclusion of proposals that relate to the election of a particular individual to membership on the board of directors. This exclusion provision should not be understood as permitting the exclusion of "rules-of-the-game" provisions that do not relate to the election of a particular individual but rather to the procedural and substantive rules that govern the elections process.

The elections exclusion aims, and should be interpreted in light of this aim, at allowing companies to omit proposals involving matters for which it is necessary to require the proposing shareholders to make disclosures in a proxy statement. In such a case, the 500 words allotted by the Rule are insufficient for shareholders to cast an informed vote without a proxy statement. When a shareholder seeks to elect a particular individual to the board, an informed vote requires a proxy statement that would provide shareholders with particularized information about the characteristic and plans of the proposed individual. This is not the case, however, when the proposal concerns not the board membership of a particular individual/s but

rather a governance arrangement – whether one regulating the election and nomination process or some other aspect of corporate governance.

The SEC staff's current position seeks to interpret the election exclusion provision as one that allows exclusion of proposals concerning not the election of a particular individual but also proposals concerning the election process that increase the likelihood of contested elections. There is no basis in the language of the Rule or otherwise for importing a requirement that a proposal not make a contested election more likely.

Such a requirement is also inconsistent with the Staff's own practice on a variety of proposal topics. Many of the proposals the Staff has required companies to include over objections founded on the Election Exclusion have involved corporate governance reforms that could or would increase the probability of a contested director election. For example, the Staff has consistently required companies to include proposals asking that the board be declassified. De-classification of the board facilitates control contests by enabling challengers to gain control of the board. Similarly, cumulative voting, which empowers minority shareholders to elect a small number of directors to the board, could well increase the likelihood of an election challenge. Companies are not allowed to exclude proposals seeking implementation of cumulative voting.

Furthermore, the Staff has refused to allow companies to omit proposals asking incumbent management to nominate two candidates for every open board seat ("Double Nominee Proposals"). By their very nature, Double Nominee Proposals guarantee an election contest. Any candidate serious about winning under that arrangement would solicit shareholder support and thus create a contest under any definition of the term. The Staff's divergent decisions regarding Double Nominee Proposals and proposals like the Proposal, which relate to inclusion of shareholder-nominated candidates, might reflect the Staff's view as to which governance arrangements are better than others. The introduction of such a preference, however, is not authorized by the Rule.

Finally, the District Court stressed that the Plan's Chairman made clear in a press release that the Plan lost faith in AIG's current board and would like to bring about a fresh start. However, what matters for determining whether the election exclusion applies is the nature of the proposal, not the motivation or the timing choice of the shareholder making the proposal. Shareholders who bring proposals to de-stagger the board, for example, are often motivated at least in part by dissatisfaction with the board and are interested in structural change that would make it easier to replace

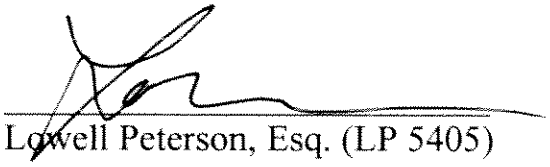
the board. Such proposals are clearly ones that companies may not exclude because the proposals themselves focus on a structural, governance change.

Proposals that seek to advance a governance, process change are not ones that may be excluded under the Rule even if they might lead to a contested election down the road and even if the shareholder making the proposal is interested in increasing the likelihood of such a contest. Many of the proposals that have long been accepted as ones that companies may not exclude are exactly such proposals. In making such decisions, shareholders will be voting on a general, rules-of-the-game question. If such a proposal is adopted and if a contested election takes place in the future, proposals for or against a particular candidate will no longer be possible to make under the Rule as a proxy statement will be required.

In sum, neither the language of the Rule nor any of the policy considerations that inform the Rule's election for office exclusion provide any basis for allowing AIG to omit the Proposal. Inclusion of the Proposal in AIG's proxy statement is critical to the Plan's ability to communicate with other shareholders given AIG's size and the dispersion of its shareholders. Accordingly, we urge this Court to grant the Plaintiff's motion for a preliminary injunction and enable AIG's shareholders to judge for

themselves whether the proxy access mechanism described in the Proposal would enhance the value of their investment in AIG.

Dated: New York, New York
August 23, 2005



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