the Corporate Governance advisor

March/April 2022 • Volume 30, Number 2

PROXY CONTESTS

SEC Resets the Shareholder Proposal Process

By Sanford Lewis

On November 3, 2021, the Securities and Exchange Commission (SEC) Division of Corporation Finance issued Staff Legal Bulletin 14L (SLB 14L). From the perspective of proponents, the bulletin resets the shareholder proposal process to: **(a)** align with the Commission's original principles and structure of SEC Rule 14a-8 (the Rule), **(b)** reduce subjectivity arising from determinations made by the Staff of the Division of Corporation Finance (the Staff), and **(c)** bring the process into line with the growing importance to the capital markets of environmental, social & governance (ESG) issues.

The need for SLB 14L is clear. A series of Staff interpretations and now-rescinded bulletins had rewritten the ordinary business exclusion to add concepts inconsistent with other exclusions. The interpretations added complexity, cost, and subjectivity to the no-action process. Moreover, by disregarding previous Commission positions and the explicit language in other exclusions in the Rule, the Staff added a high degree of unpredictability to the process.

The adopted rules of the full Commission cannot be overturned by the Staff's intervening

Continued on page 2

Sanford Lewis is Director of the Shareholder Rights Group.

Wolters Kluwer

CONTENTS

guidance. The new bulletin SLB 14L has appropriately revoked non-conforming administrative guidance and realigned Staff interpretation with that of the Commission[1] and the language of Rule 14a-8. The result is an approach more consistent with investor concerns, current governance practices, societal norms, and systemic risks.

Representatives of the corporate bar have made "the sky is falling"-type assertions, alleging that SLB 14L will allow a flood of inappropriate new shareholder proposals or even that it radically redefines the purpose of a corporation to demand socially conscious citizenship of corporations. These views are not well founded and largely ignore the serious legal concerns regarding the positions taken by the Staff since 2017.

The Basics of Rule 14a-8

Like a good architect renovating a historically significant building, the new bulletin has identified and restored the fundamental structure of Rule 14a-8. SLB 14L makes corrections that brings the no-action process back into alignment with the actual language of the Rule and interpretive positions espoused by the Commission.

Under the plain language of the Rule, augmented by Commission guidance in its formal releases,[2] there are a few key touchstones within the shareholder proposal Rule:

- **Ask for specifics.** A proposal should "state as clearly as possible the course of action" that the proponent believes "the company should follow"[3] as an advisory "request" for company action. Rule 14a-8(a).
- **Demonstrate relevance.** A proposal should be relevant to the company receiving it. Rule 14a-8(i)(5).[4]
- **Evaluate implementation.** A proposal should not ask for actions already implemented by the company. Rule 14a-8(i)(10).[5]

In addition to those "bones" of the Rule, the Rule allows exclusion of a proposal if it inappropriately intrudes on the discretion of board and management by addressing only the "ordinary business" of the company. Rule 14a-8(i)(7). However, the Commission has made clear that the ordinary business exclusion does not apply to matters of significant social policy.

Over time, Staff interpretations of the ordinary business exclusion have produced inconsistent

Issue	Language of Rule and the Commission	Staff-Added Guidance Eliminated by SLB 14L
Specificity Assessing whether the proposal requests specific action from the company	14a-8(a): The proposal "should state as clearly as possible the course of action you believe the company should follow" 14a-8(i)(3) with 14a-9: Excludes proposal that is misleading as vague or indefinite	SLB 14I, 14J, 14K: Allowed Staff to exclude under 14a-8(i)(7) proposal as micromanaging if proposal addressed "outcomes" or "strategies"
Relevance Assessing the significance of the proposal to the company	14a-8(i)(5): Excludes a proposal if it is not economically relevant or otherwise significant to the company's business	SLB 14E (2009): Case-by-case determination of "nexus" evaluating significance to company under 14a-8(i)(7) rather than 14a-8(i)(5) SLB 14I, 14J, 14K (2017-2019): Criteria on significance to the company added such as prior votes, other investors' interest, delta analysis, and more
Implementation Assessing existing company activities against the proposal	14a-8(i)(10): Excludes a proposal if it is substantially implemented by existing company actions	SLB 14I, 14J, 14K: "Delta" (difference) analysis under 14a-8(i)(7) asked the board to opine on whether implementing the proposal would not be a significant difference for the company from existing company actions

add-ons to the clearly articulated principles of the Rule. Several Staff interpretations, beginning as early as 2009, deviated from core concepts of Rule 14a-8 as adopted by the Commission. Staff Legal Bulletin 14L resets the process to eliminate these deviations. The chart below summarizes the issues that will be discussed further in the following sections of this article.

Ordinary Business According to the Commission

In 1998, the Commission issued a release (the 1998 Release) interpreting the Rule, both reiterating and clarifying past approaches. That release discussed at length the ordinary business exclusion. The release overturned the Commission's prior position that employment-related proposals (e.g., affirmative action proposals) affecting rank-and-file employees were to always be treated as excludable ordinary business. [6]

In deciding to allow employment-related proposals that addressed a significant social policy issue to appear in the proxy, the Commission noted that it was adjusting the Rule to better meet the needs of investors:

We have gained a better understanding of the depth of interest among shareholders in having an opportunity to express their views to company management on employment related proposals that raise sufficiently significant social policy issues.

The Commission went on to summarize **two central considerations** in ordinary business determinations—significant social policy issues and micromanagement.

First, that certain tasks were generally considered so fundamental to management's ability to run a company on a day-to-day basis that they could not be subject to direct shareholder oversight (e.g., the hiring, promotion, and termination of employees, as well as decisions on retention of suppliers, and production quality and quantity). However, proposals that related to such matters but *focused on sufficiently significant social policy issues* (i.e., significant discrimination matters) generally would *not* be excludable.

Second, proposals could be excluded to the extent they seek to "micromanage" a company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment. The concern did not, however, result in the exclusion of all proposals seeking detailed timeframes or methods. As the 1998 Release indicated:

Timing questions, for instance, could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations.

In discussing the topic, the 1998 Release referenced *Capital Cities/ABC, Inc.* (Apr. 4, 1991), a No-Action letter agreeing with the company's arguments on the exclusion of a proposal that requested details on the company's affirmative action policies and practices.

We did not intend to imply that the proposal addressed in Capital Cities, or similar proposals, would automatically amount to "ordinary business." **Those determinations will be made on a case-by-case basis, taking into account factors such as the nature of the proposal and the circumstances of the company to which it is directed.** [emphasis added]

The case-by-case analysis would be applied to the second prong of ordinary business, micromanagement. Proposals that passed the first prong but for which the wording involved some degree of micromanagement could be subject to a case-by-case analysis of *whether the proposal probes too deeply* for shareholder deliberation.

The interpretation provided by the Commission was, however, altered in a series of legal bulletins starting in 2009.

Staff Legal Bulletin 14E

The 2009 Staff Legal Bulletin 14E (SLB 14E)[7] added a highly subjective and additional interpretive task to Rule 14a-8(i)(7)—a "significance to the company" inquiry—to evaluate *under the ordinary business rule* whether there was sufficient *nexus* between a significant policy issue and the company. While Staff had been informally considering this concept of nexus in no-action decisions, SLB 14E represented a formal adoption of the concept by the Staff and began a process of interpretation, and an array of decision principles, inconsistent with the language of the Rule itself.

The interpretation altered the ordinary business exclusion in a manner inconsistent with Commission interpretation and with the structure of the Rule and was unnecessary because the "nexus" concept already existed in a separate exclusion.

Rule 14a-8(i)(5) permits the exclusion of proposals that are not "relevant" to a company's business. The exclusion originally applied to proposals involving "a recommendation, request, or mandate that action be taken with respect to any matter, including general economic, political, racial or religious, social or similar" nature that were "not significantly related to the business of the issuer."[8] While undergoing changes and amendments over time, the "significantly related to the company's business" language remained an important requirement.

Proposals would be unlikely to pass muster under Rule 14a-8(i)(5) if unrelated to the company's business: a proposal on animal cruelty related to foie gras submitted to a company that neither sold nor produced the product would be excludable, as would a proposal on human rights in a region of the world where the receiving company did not do business. Where, however, the proposal implicated the actual business of the company and involved matters of social policy, exclusion was rarely permitted.[9]

The search for a "nexus," therefore, was unnecessary and sidestepped and created potential conflict with the exclusion in Rule 14a-8(i)(5). Moreover, the shift led to more than a decade of lawyerly pontification in no-action requests of ever-increasing length and complexity as to whether a significant policy issue had sufficient nexus to the company's business.

Staff Legal Bulletins 14I, 14J, and 14K

Staff Legal Bulletins 14I, 14J, and 14K issued from 2017 to 2019 amplified the case-by-case "nexus" determinations of SLB 14E by offering a wide array of new "significance to the company" tests that expanded the concept of nexus. Bulletins 14I-J-K multiplied the number of *significance to the company* arguments that an issuer or its board of directors could present in an attempt to persuade the Staff to exclude a proposal under either Rule 14a-8(i)(7) or Rule 14a-8(i)(5).[10]

Using these new bases, the Staff began to deem proposals excludable in ways that increasingly deviated from and overshadowed the criteria of the relevancy exclusion in Rule 14a-8(i)(5). Effectively issuers were given two bites from the apple in making the case that a proposal was not sufficiently connected to a company's business. No-action letters became significantly longer and the process more complex. In addition, the "nexus" approach resulted in the exclusion of many proposals that would otherwise have survived an analysis under Rule 14a-8(i)(5).

For instance, the Staff in *J.P. Morgan Chase & Co.* (March 26, 2021) excluded a proposal on the company's underwriting of dual-class share offerings by focusing on significance to the company under Rule 14a-8(i)(7). The Staff wrote:

In our view, the Proposal does not demonstrate how underwriting equity offerings with different class structures is a significant policy issue for the Company, such that it transcends the Company's ordinary business operations and would be appropriate for a shareholder vote.

This determination ignored the fact that J.P. Morgan, due to its position as a leading underwriter, has a significant effect on the extent of multiclass share offerings, which would have made the proposal "otherwise significant to the company's business" under Rule 14a-8(i)(5). Instead, the Staff exclusion appears to have focused only on the direct economic importance to JP Morgan, rather than other issues of proper concern to shareholders, namely the systemic effect of the company on its industry, society, and capitalism at large.

Kohl's Corporation (February 19, 2021) presents another example of a company arguing, and the Staff accepting, a significance to the company argument based on Rule 14a-8(i)(7) instead of 14a-8(i)(5) to override the important social policy issue raised by the proposal. The proposal in *Kohl* asked the board to analyze and report on the feasibility of including paid sick leave as a standard employee benefit not limited to the time of COVID-19. Staff allowed exclusion based on ordinary business under Rule 14a-8(i)(7). In particular, the Staff decision noted that:

[P]roposals related to paid sick leave may raise a significant policy issue that transcends a company's ordinary business operations. However, in our view, the Proposal does not demonstrate how offering paid sick leave as a standard employee benefit is sufficiently significant to the Company, such that it transcends the Company's ordinary business operations and would be appropriate for a shareholder vote.

Kohl's policy on sick leave has an evident effect on its stakeholders that would, under the rule, make the proposal not excludible under Rule 14a-8(i)(5) as an issue that is both economically significant to the company AND otherwise significant to the company's business.

The bulletins also added new requirements to exclusions that appeared in other parts of Rule 14a-8. The Rule includes, in subsection (i)(10), an exclusion for proposals already implemented.[11] Yet, in 2018, Staff Legal Bulletin 14J established a new test which allowed a board to opine on whether it observed a sufficient "delta" between existing company activities and those requested by a proposal.

This novel concept allowed a board to opine on its existing activities and whether it saw a significant difference between a proposal's requests and existing company actions. The approach was inconsistent with Rule 14a-8(i)(10) which evaluates whether a proposal is substantially implemented by examining whether existing company activities fulfil the guidelines and essential purpose outlined by the proposal.

The 14I-J-K bulletins also radically expanded the concept of micromanagement beyond what was set forth by the Commission.

Instead of continuing to focus micromanagement analysis on the long-standing approach of whether the level of detail in the proposal delved too far into the minutiae of company operations, or whether it was written in a manner that "probes" at a level consistent with shareholder deliberation and debate, the bulletins added a new principle allowing an advisory proposal to be excludable if it suggested a specific *outcome* or *strategy*, a wholly new standard.[12]

This overly expansive approach significantly broadened the subjective opportunities for Staff to block previously acceptable proposals, such as a request to set greenhouse gas targets aligned with global climate goals, a request that is neither too complicated for shareholder deliberation and debate nor delves too deeply into the minutiae of how to set and apply such targets.[13]

Assessing the Added Staff Interpretations

Each of the above add-ons and decision-making criteria were inconsistent with the original core principles of the rules regarding specificity, relevance, and implementation. Instead of empowering and protecting shareholders—which is the SEC's mandate—these subjective Staff interpretations made the filing of proposals more expensive and uncertain.

Each also represented a significant deviation from the plain language and structure of the original Rule. They increased the number of grounds on which a given proposal could be challenged and made outcomes highly unpredictable and dependent on subjective board and Staff analysis. Proposals necessarily began to take an increasingly vague form to attempt to survive the greatly expanded concept of micromanagement only to be caught on the shoals of the substantially implemented provisions or other new Staff criteria; other proponents were simply discouraged from filing proposals given the uncertainties and costs.

What SLB 14L Accomplishes

The new bulletin effectively realigns Staff interpretation with the requirements of the Rule and prior positions taken by the full Commission. Its adoption should reduce uncertainty and the contentiousness of the no-action process regarding a number of pivotal issues:

1. *Micromanagement*

The right of shareholders to make the requests in their proposals as clear as possible—which is stated in the original Rule itself—has been restored. Advisory proposals on a significant policy issue—such as climate change—that request targets, or improvements in performance at the scale, pace, and rigor required by public policy goals are <u>no longer</u> considered micromanagement unless the proposal attempts to direct the minutiae of operations.

The new bulletin resets the interpretation of micromanagement to focus on whether the granularity of the proposal is consistent with shareholders' capacity to understand and deliberate; i.e., proponents are expected to tailor proposals to a level of inquiry that is consistent with the current state of investor discourse and knowledge.

The bulletin provides clear guidance consistent with the Commission's 1998 Release on the criteria that Staff will use to ascertain whether a proposal "probes too deeply" and seeks to micromanage the company. As an example, it examines whether the issues in the proposal are discussed within the bounds of recognized national or international guidelines.

2. *Significant Policy Issue and Social Effect*

A policy issue is said to transcend ordinary business when it involves an issue of significant societal effect. This is consistent with the 1998 Release as well as the current needs and focus of investors. This is discussed further below.

3. *Significance to the Company Is Evaluated under Rule 14a-8(i)(5)*

The bulletin eliminates misdirected interpretive guidelines regarding significance—such as the application of "delta," and the interjection of board opinions. Significance to the company of a policy issue is evaluated under Rule 14a-8(i)(5)—rather than Rule 14a-8(i)(7)—and a proposal that does not meet the economic tests of the Rule will be deemed "otherwise significantly related" to the company under Rule 14a-8(i)(5) if it addresses societal effects or ethical issues that are relevant to the company's business.

That said, a key requirement under 14a-8(i)(5) remains—a proposal that addresses a social or ethical issue must be relevant to the company's business.[14] A proposal that seeks a general plebiscite on a social or ethical issue on which the company has no effect or involvement would be unlikely to pass 14a-8(i)(5)'s "otherwise significantly related to the company's business" test.

4. *Email, Graphics, and Proof of Ownership*

SLB 14L also contains technical guidance on several logistical and technical issues in filing. For instance, it encourages proponents to use email to file proposals and respond to deficiency notices, while warning that proof of receipt should demonstrate that a person actually opened the email on the receiving end.

In addition, the bulletin reiterates that graphics can be included in proposals provided they do not violate other exclusions under the Rule. It also reinforces the notion that proof of ownership should not devolve into a game of technical "gotcha" and that reasonable proof of continuous beneficial ownership should suffice.

5. *Fit for Purpose: Supporting the Rights and Responsibilities of All Investors*

Resuming the renovation metaphor—an architect undertaking renovation looks to restore the structure to its original elegance, but to also meet the needs of current users — the Staff's renovation of the no-action process achieves high marks on both counts. The no-action process has been restored to reflect the original intentions and efficiencies of the Rule.

Considering the needs of users, SLB 14L reinstates a fundamental principle laid out by the Commission—that important social policy issues can be addressed through shareholder proposals. This appropriately reflects the groundswell of investor concern about materially important environmental, social, and governance (ESG) matters. SLB 14L's restatement that *societal effect* transcends ordinary business considerations is entirely consistent with the Rule and with our changing times.

Echoing the words of the 1998 Release, the new bulletin reflects an understanding of the "depth of interest among shareholders in having an opportunity to express their views to company management."

The 2021 proxy season saw record voting support for ESG proposals. This underscores that shareholder democracy is a critical tool for investors to drive improvements in disclosure and performance on issues they deem materially important, such as social and environmental matters, that are understood to drive long-term profitability for companies and portfolios.

ESG is mainstreaming because of demonstrated correlations to material financial outcomes and considerations of systemic risks and opportunities (such as climate change) which are concerns for all long-term, diversified investors.[15] In this way, SLB 14L goes hand-in-hand with the important Commission efforts underway to propose mandatory ESG disclosure rules.

SLB 14L does make it easier for shareholders to write clear and specific proposals that will survive a no-action challenge—which is a good thing. In 2021, it was reported that 71 percent of no-action challenges were successful, confounding the goal of giving shareholders a voice on issues of material concern. Allowing more proposals to make it into the proxy for review and consideration by shareholders, management, and boards is both useful and appropriate.

It is important to remember that while the original intent of the Commission has been restored by SLB 14L, and certain types of proposals that were previously excludable will now be permitted again (because they are of clear and appropriate interest for investor deliberation), filing a shareholder proposal is still a quite substantial and heavy lift for most investors, and there is little evidence that the overall number of proposals filed will surge in 2022.

In Closing

Ultimately, the ability of a shareholder proposal to produce beneficial change at a corporation is grounded in a fundamental test—whether shareholders vote in favor of the proposal. This inevitably turns on shareholders' assessment of whether the proposal will advance value on a short- or long-term basis, whether at the individual company or across the economy. For this reason, the corporate bar's alleged concern that the shareholder proposal process could turn into a plebiscite on general issues of political or social debate is entirely unfounded. Indeed, exclusion of a too-general political or social proposal is the most likely outcome when a proposal is not relevant to a company's core business.

SLB 14L strengthens Rule 14a-8 within the larger matrix of evolving rights and responsibilities of investors. It has become clear that the process of investors exercising their legal right to file proposals is accomplished within a broad framework of accountability—including public and legal scrutiny of institutional investor voting, and whether fiduciaries are engaged in sufficient due diligence in accordance with a transparent set of principles.

To the extent that a fiduciary has adopted ESG principles, their votes on shareholder proposals will be scrutinized as one of the most visible means of determining whether their commitment to ESG is bona fide.[16]

A shareholder proposal provides an essential opportunity for a company to hear from its shareholders as to whether a given issue should be given elevated attention by board and management. For this reason, Staff Legal Bulletin 14L is the right reform undertaken at the right time in a way that will benefit all investors, not just those looking to implement important ESG missions and principles.

Notes

1. *See* SLB 14L. ("Going forward, the staff will realign its approach for determining whether a proposal relates to 'ordinary business' with the standard the Commission initially articulated in 1976, which provided an exception for certain proposals that raise significant social policy issues, and which the Commission subsequently reaffirmed in the 1998 Release.")

2. For a general overview of the history of the Rule, see Brown, J. Robert (2016). The evolving role of Rule 14A-8 in the corporate governance process. *Denver University Law Review Online*, *93*, 151. U Denver Legal Studies Research Paper No. 16-16, Available at SSRN: *https://ssrn.com/abstract=2767712* (go back)

3. Rule 14a-8(a).

4. Rule14a-8(i)(5) provides for exclusion "[i]f the proposal relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, **and is not otherwise significantly related to the company's business**." (emphasis added). Note that this Rule in its genesis was originally referred to as a test of "insignificance to the company."

5. Rule 14a-8(i)(10) provides for exclusion "if the company has already substantially implemented the proposal."

6. The position delineated in *Cracker Barrel* (October 13, 1992).

7. SLB 14E made an important breakthrough determination that shareholder requests for a company to conduct a risk analysis of a social policy issue—*risk* being an obvious core interest to investors—would *not* be routinely excludable as ordinary business, provided that the underlying subject matter addressed a *significant social policy issue.*

8. SEC Securities Exchange Act Release No. 34-9784, 1972 WL 125400 (Sept. 22, 1972).

9. *www.denverlawreview.org/dlr-online-article/2016/5/6/sec-rule-14a-8i5-is-it-still-relevant.html#_ftn53*. "For the most part, the Staff found that proposals involving a small percentage of earnings or assets, but that nonetheless raised important social issues were significantly related to the company's business."

10. Rescinded Staff Legal Bulletin 14J integrated several new and problematic factors of "significance to the company" for a board of directors to opine on in their arguments for exclusion, such as "whether the company has already addressed the issue in some manner, including the differences—or the delta—between the proposal's specific request and the actions the company has already taken, and an analysis of whether the delta presents a significant policy issue for the company," and "whether anyone other than the proponent has requested the type of action or information sought by the proposal."

11. For a discussion of this exclusion, *see www.denverlawreview.org/dlr-online-article/2016/5/6/rule-14a-8i10-how-substantial-is-substantially-implemented-i.html*.

12. Staff Legal Bulletin 14 J stated: "In considering arguments for exclusion based on micromanagement… we look to whether the proposal seeks intricate detail or imposes a specific **strategy, method, action, outcome or timeline** for addressing an issue, thereby supplanting the judgment of management and the board." [emphasis added] This contrasts with the explicit language of Rule 14a-8(a), which says that the proponent should be "as specific as possible" in a proposal's request to a company. The new considerations awkwardly placed the Staff in a highly subjective decision-making process with little helpful guidance.

13. The climate proposals that were allowed to be excluded in the prior administration involved advisory proposals asking a company to develop greenhouse gas targets aligned with particular external policy or scientifically designated goals, e.g., net zero by or alignment with the Paris agreement temperature goals. For example, *PayPal Holdings Inc.* (March 6, 2018), *Deere & Company* (December 27, 2017), *Apple Inc.* (December 21, 2017), *Verizon Communications Inc.* (March 6, 2018), *Apple Inc.* (December 5, 2016), *Amazon.com, Inc.* (March 6, 2018). The Staff decisions asserted that the proposals were "probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

14. In a recent podcast, former SEC Special Counsel Keir Gumbs suggested that it was only *nexus under Rule 14a-8(i)(7)* that prevented a proposal on guns from being excludable at a company that neither produces nor sells guns. Yet, a proposal that fails the 5 percent economic criteria of Rule 14a-8(i)(5) would still be required to address a social or ethical issue that is "otherwise is significantly related to the company's business" in order to qualify as relevant under Rule 14a-8(i)(5).

15. *See*, for instance, Gordon, Jeffrey N., Systematic Stewardship (February 14, 2021), forthcoming 2022 Journal of Corporation Law. Available at SSRN: *https://ssrn.com/abstract=3782814* or *http://dx.doi.org/10.2139/ssrn.3782814*.

16. A newly proposed Rule to require data-tagged reporting of proxy votes is likely to drive demand for better alignment of votes with ESG brands. See proposed Rulemaking, S7-11-21 re enhanced reporting of proxy votes, which would enable more vote comparisons.

Say-on-Pay Failures and Board Demographics

By Paul Hodgson

Proxy season 2021 was quite a year for failed management of Say-on-pay votes, so ISS Corporate Solutions decided to take a look at a number of measures for board demographics to see if boards which performed poorly on Say-on-pay votes had particular characteristics. What we found was that companies that did have lower Say-on-pay votes have whiter, more male, shorter tenured, and slightly older directors than companies with higher votes, according to an analysis of voting data for the last four years.

This year felt like a banner year for Say-on-pay failures, with many high-profile defeats. While this is true for companies receiving less than 50 percent support on their Say-on-pay proposals, which give shareholders the ability to voice their opinion on executive pay programs, prior years showed more companies receiving less than 70 percent support than in 2021. For example, 59 companies experienced failed Say-on-pay votes in 2021, compared to 49 in 2020, 51 in 2019, and 44 in 2018. However, while an additional 90 companies received less than 70 percent support in 2021, 109 did so in 2020, 122 in 2019, and 119 in 2018.

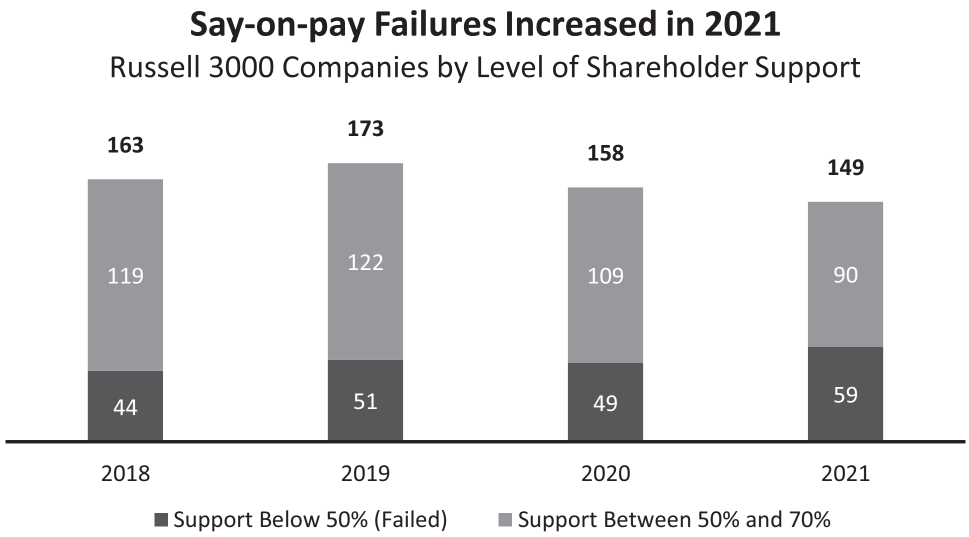
Interestingly, it was not just high-profile, large companies that were the target of shareholder disapproval. Among the S&P 500, S&P 400, S&P 600, and Russell 3000 excluding the S&P 1500, the greatest number of companies that failed to receive a majority of support for their Say-on-pay resolution in 2021 were in the S&P 500, at 18 companies, or 3.6 percent of the index, but the other failed votes were among much smaller companies. By percentage, we see a similar proportion to that found in the S&P 500 in the S&P 400, where 15 companies, representing 3.8 percent, of the index failed to garner majority support for their Say-on-pay proposal. Fewer companies failed to receive majority support in the Russell 3000 excluding the S&P 1500 (9.3 percent or 14 companies), with just 11, or 1.8 percent, failed proposals in the S&P 600.

In 2021, some sectors fared worse than others. Industries that were most severely affected include software and services, real estate, and energy in which 11, seven, and five companies experienced failed Say-on-pay outcomes, respectively. New rulemaking from the Securities and Exchange Commission (SEC) at the end of September will also make it easier for investors and companies to know where these votes are coming from, as it will enhance reporting of Say-on-pay votes by institutional investment managers.[1]

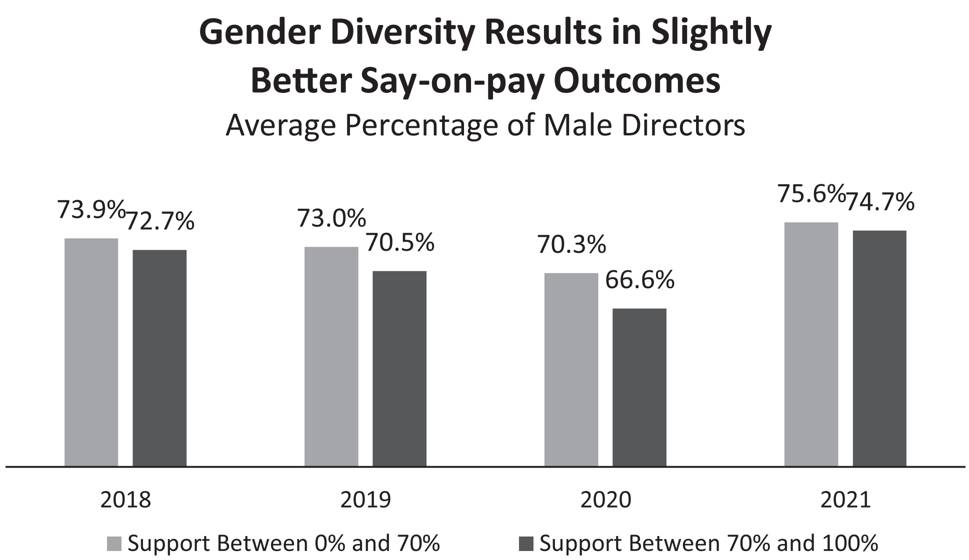
© 2022 ISS Corporate Solutions. Paul Hodgson is Senior Editor of ISS Corporate Solutions.

the Corporate Governance advisor

The ***CORPORATE GOVERNANCE ADVISOR*** (ISSN 1067-6171) is published bimonthly by Wolters Kluwer at 28 Liberty Street, New York, NY 10005. Subscription rate, $960 for one year. POSTMASTER: Send address changes to *THE CORPORATE GOVERNANCE ADVISOR,* Wolters Kluwer, 7201 McKinney Circle, Frederick, MD 21704. Send editorial correspondence to Wolters Kluwer, 28 Liberty Street, New York, NY 10005. To subscribe, call 1-800-638-8437. For Customer service, call 1-800-234-1660.



Source: ICS Governance Analytics



Source: ICS Governance Analytics

To determine whether board demographics played a role in Say-on-pay vote results, ISS Corporate Solutions analyzed data on board composition and found that companies that had Say-on-pay votes of 70 percent or more and companies that had votes of less than 70 percent had certain characteristics in common. For example, the average percentage of male directors on boards at companies with Say-on-pay votes of 70 percent and above was 74.7 percent in 2021. Boards of companies with Say-on-pay votes below 70 percent had an average percent of male directors at 75.6 percent.

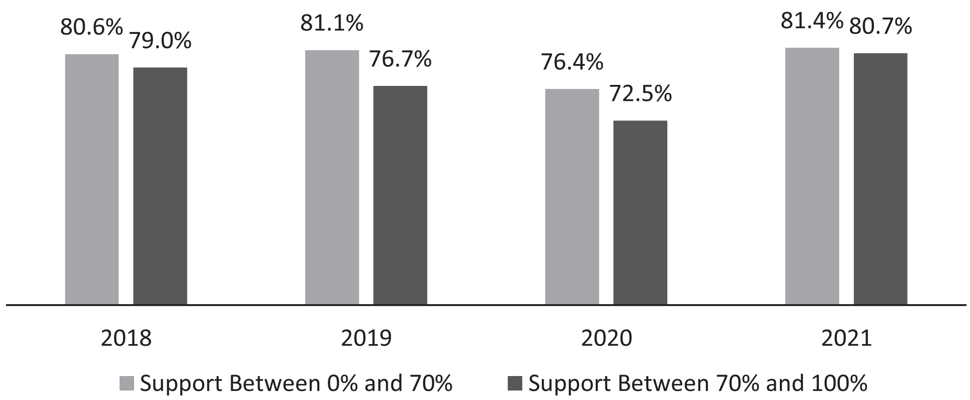
For the purposes of the analysis, we excluded newly elected directors from each year's analysis, as these directors would not have been responsible for making any of the relevant pay decisions that were met with either approval or disapproval from shareholders. We did include all other members of the board in the analysis, rather than just members of the compensation committee. While compensation committee members make detailed decisions about executive pay packages, pay is ultimately approved by the full board.

A similar differential—higher percentage of male directors corresponding with Say-on-pay below 70 percent—was seen in each of the other three years studied, with the widest spread occurring in 2020 (3.7 percentage-points).

Similarly, in 2021, directors on boards of companies with Say-on-pay votes of 70 percent or more were, on average, 80.7 percent Caucasian. This compares to boards of companies with Say-on-pay votes below 70 percent which had an average percent of Caucasian directors at 81.4 percent. As with the gender analysis, similar differentials were seen in each

Ethnic Diversity Results in Slightly Better Say-on-pay Outcomes

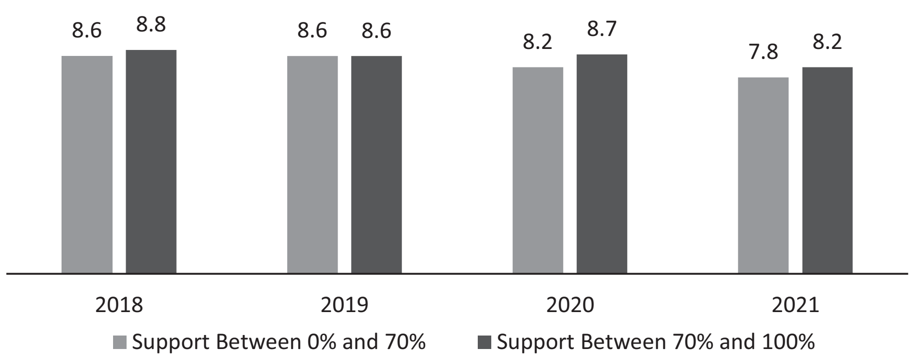
Average Percentage of Caucasian Directors



Source: ICS Governance Analytics

Lower Say-on-pay Support is Modestly Linked to Shorter Director Tenure

Average Director Tenure (in Years)



Source: ICS Governance Analytics

of the other three years studied, with the biggest percentage-point difference this time in 2019 (4.2 percentage-points).

The findings on director tenure, while relatively consistent year over year, show a smaller spread than the figures for gender and race, with Say-on-pay votes below 70 percent generally going to boards with shorter average director tenure. The largest spread occurred in 2021, at 0.4 percentage-points, though, in 2019, the average tenure was the same for both groups of directors.

As with tenure, the differentiation between average director age among the two groups is less significant. The average age among board members was the same in 2021, but in each of 2020, 2019, and 2018, directors with Say-on-pay support below 70 percent had average ages that were slightly higher.

Finally, we looked at the relative board independence for the two groups. Findings for the average percentage of independent directors on the board did not allow us to draw any firm conclusions. The average percentage of independent directors on the boards of companies with Say-on-pay votes below 70 percent was higher in 2020 and 2019, but lower in 2021 and 2018.

Received wisdom might suggest that more independently, female, ethnically diverse, younger boards with good rates of board refreshment would be those most likely to make pay decisions that were met with shareholder approval. Our findings generally agree with that received wisdom, except for board refreshment where pay decisions that received significant shareholder votes against were more often made by shorter-tenured directors, although perhaps this speaks to the value of experience. In addition, findings on independence were inconclusive over the study period.

It should be remembered that a poor Say-on-pay vote can have further consequences if corporations do not reach out to investors to discuss their concerns about the pay programs in question and listen to suggested amendments. If action is not taken, many institutional investors' proxy voting policies suggest voting against directors on the compensation committee the following year. This can lead to poor public and stakeholder relations and damage to a company's reputation. ISS Corporate Solutions can help with both a review of pay practices among a company's peers to aid in identifying where differences in practice may have led to a poor vote. It can also help look at the peer disclosures surrounding board demographics, which are likely to be mandated soon under the current SEC.

Note

1. SEC Proposes to Enhance Proxy Voting Disclosure by Investment Funds and Require Disclosure of "Say-on-Pay" Votes for Institutional Investment Managers, September 29, 2021.

SEC Adopts Mandatory Universal Proxy Rules

By Sean Donahue, John Newell, Folake Ayoola, Jim Hammons, and Lauren Visek

The U.S. Securities and Exchange Commission (SEC) approved mandatory "universal proxy" on November 17, 2021. The final rules will apply to contested director elections at shareholder meetings held after August 31, 2022. The SEC also approved amendments that will clarify the shareholder voting options in all director elections. When the universal proxy rules become effective on September 1, 2022, they will significantly change the proxy mechanics for contested director elections.

The rules provide that each of the company's and dissident's proxy card in a contested director election will now be required to include all director nominees up for election, rather than only those of the company or dissident filing the proxy statement. In this regard, the universal proxy rules provide dissidents with a new way to access a company's proxy card in contested director elections, and unlike "proxy access" bylaws, without having to meet any share ownership thresholds or holding period requirements. To do so, dissidents will need to file their own definitive proxy statement and solicit at least 67 percent of the voting power of the shares entitled to vote on the election of directors at the meeting.

What Companies Should be Doing Now

The SEC approved the universal proxy and other proxy-related amendments just over five years after the original proposal, discussed in this Goodwin alert, in October 2016. Although none of the amendments will apply to shareholder meetings involving director elections (or, in the case of the universal proxy amendments, shareholder meetings involving contested director elections) held before September 1, 2022, we recommend that all companies review the amendments now to evaluate the effect on the company's proxy statement, proxy card, advance notice bylaws and the state of its overall shareholder activism preparedness.

Although most calendar year-end companies will encounter the amendments in the context of their 2023 annual shareholder meetings, the amendments will apply to any shareholder meeting that involves director elections held after August 31, 2022. The rules do not apply to shareholder meetings called to approve a merger, consolidation, or other plan if the election of directors is an integral part of the plan.

Director Election Standards Disclosure and Voting Options. The amendments include new requirements with respect to proxy statement disclosure about voting options and voting standards that will apply to all proxy statements that include the election of directors. Although these amendments will not apply to proxy statements for shareholder meetings held before September 1, 2022, we recommend that companies begin reviewing the accuracy and clarity of their proxy statement and proxy card disclosure now, with special attention to disclosure about:

- The voting standard for director elections under the company's organizational documents and state law, including the number of votes required and whether "withheld," "against," or "abstain" options are legally applicable to elections of the company's directors;

- The effect of abstentions, broker non-votes and, to the extent applicable, withholding authority to vote for a nominee on director elections; and

- The requirements that apply to director nominations by shareholders under the company's

 Sean Donahue, John Newell, Folake Ayoola, Jim Hammons, and Lauren Visek are attorneys of Goodwin Procter LLP.

advance notice bylaws, proxy access bylaws, or other provisions of its organizational documents.

When the amendments become effective, SEC rules will require disclosure about the effect of voting choices in director elections. The amendments will also impose specific requirements and prohibitions with respect to voting options on proxy cards. As part of their review of their overall shareholder activism preparedness, companies may wish to review these new requirements.

Shareholder Nomination Procedures Disclosure. The amendments require companies to disclose in their proxy statements the deadline for shareholders to give timely notice to the company of director nominations pursuant to the new universal proxy rule (Rule 14a-19) for the next annual meeting (new Rule 14a-5(e)(4)).

Although the amendments do not apply to annual shareholder meetings held before September 1, 2022, we recommend that companies with a December 31 year-end review the disclosure that will be included in their 2022 proxy statements to ensure that the proxy statement accurately describes the shareholder director nomination requirements and process, especially the applicable advance notice, proxy access, and Rule 14a-8 deadlines.

Advance Notice Bylaws. The amendments impose very few conditions on the use of the universal proxy rules by dissident shareholders. Advance notice bylaws can play an important role in protecting companies and their shareholders from abuse of the proxy solicitation and director elections process. Companies should review their advance notice bylaws and determine whether amendments would be appropriate in light of recent judicial decisions and emerging best practices.

Companies Subject to the Universal Proxy Rules

The universal proxy rules will not apply to registered investment companies or business development companies, but the amendments that require disclosure about the effect of "withheld" votes on director elections and the requirements that apply to voting choices on proxy cards will apply to such companies. Because foreign private issuers are exempt from SEC proxy rules, they will be exempt from all of the amendments.

Proxy Solicitations Subject to the Amendments

As noted above, the universal proxy rules will apply to proxy solicitations in contested director elections at shareholder meetings held after August 31, 2022, without regard to when the proxy solicitation began, unless the proxy solicitation is exempt under SEC rules.

The universal proxy rules will not apply to consent solicitations, nor will they apply to shareholder meetings held to approve a merger, consolidation, or other plan if the election of directors is an integral part of the plan. The amended rules that require proxy statement disclosure about the effect of "withheld" votes on director elections and require certain voting choices on proxy cards will apply to all director elections, including uncontested elections, held after August 31, 2022.

Amendments Applicable to All Director Elections

The SEC adopted several amendments that are not related to the universal proxy process.

- When applicable state law gives legal effect to votes cast against a nominee, the proxy card must provide a means for shareholders to vote against each nominee and a means for shareholders to abstain from voting, rather than providing a means to withhold authority to vote.
- When applicable state law does *not* give legal effect to votes cast against a nominee,

the proxy card shall not provide a means for shareholders to vote against any nominee. Instead, the proxy card must clearly provide one of the four means specified in Rule 14a-4(b) for shareholders to withhold authority to vote for each nominee.

- The proxy statement must disclose how votes will be counted, including the treatment and effect abstentions, broker non-votes, and, to the extent applicable, withholding authority to vote for a nominee in an election of directors under applicable state law and a company's organizational documents.

- The company's proxy statement must disclose the deadline for providing notice of a solicitation of proxies in support of director nominees, other than the company's nominees, pursuant to a universal proxy solicitation under Rule 14a-19 for the company's next annual meeting.

Universal Proxy Rules

The basic principle of the universal proxy rules is that shareholders who do not attend a shareholders' meeting in person—and therefore must vote their shares by authorizing someone else to vote their shares as the shareholder instructs—should be able to vote in the same way as shareholders who attend the meeting in person.

Historically, shareholders who attended a meeting in person could vote for a mix of management nominees and dissident nominees if there were a director election contest. Shareholders voting by proxy, in contrast, were effectively limited to a choice between voting for *all* of the company's director nominees or *all* of the dissident director nominees because they could only vote on the company's or the dissident's proxy card.

The two central parts of the universal proxy rules are the required use of a "universal" proxy card by both the company and the dissident shareholder and a series of specific notice and filing requirements that apply to the company and the dissident shareholder.

Universal Proxy Card. "Universal" means, for purposes of the SEC's universal proxy rules, that both the company's proxy card and the dissident's proxy card must provide the option to give voting instructions for each of the director candidates nominated by the company and the dissident shareholder, including any combination of nominees chosen from both groups. If the dissident has nominated a complete slate of candidates, the universal proxy card can also permit shareholders to give voting instructions to vote for either all of the company's nominees as a group or all of the dissident's nominees as a group.

The universal proxy rules do not require that the company's proxy card and the dissident's proxy card be the same. The rules do contain requirements that universal proxy cards must satisfy regarding presentation, formatting, and disclosure. The principal requirements include:

- List the names of all persons nominated for election by the company and by the dissident, in alphabetical order, using the same font type, style, and size for all nominees;

- Clearly distinguish between the company's nominees and the dissident's nominees;

- Prominently state the maximum number of nominees for which the shareholder can grant authority to vote;

- Provide a way for the shareholder to grant authority to vote for each of the nominees;

- If the dissident has nominated a full slate of candidates, the proxy card may provide a way for the shareholder to grant authority to vote for all nominees of the company or the dissident as a group, but in that case must also provide a way for the shareholder to withhold authority to vote for all of the company's nominees and all of the dissident's nominees as a group; and

- Prominently disclose the treatment and effect of a proxy card that (1) grants authority to vote for fewer or more directors than are to be elected or (2) does not grant authority to vote for any nominees.

Because it is possible that a dissident will abandon its proxy solicitation after the company has begun its own proxy solicitation with a universal proxy card that lists a dissident's nominees, the universal proxy rules require the company to disclose in its proxy how the company intends to treat proxy authority granted in favor of the dissident's nominees if the dissident abandons its solicitation or fails to comply with SEC proxy rules.

Minimum Number of Shareholders Solicited by Dissident. In contrast to Rule 14a-8 and most "proxy access" bylaws, which require that shareholders satisfy minimum ownership thresholds and holding periods requirements in order to have a proposal or director nomination included on the company's proxy card, the universal proxy rules require only that a dissident who wishes to use the universal proxy process file its own definitive proxy statement and solicit the holders of at least 67 percent of the voting power of shares entitled to vote on the election of directors at the shareholder meeting, and include a statement to that effect in its proxy statement or proxy card. This requirement reflects an increase from the original proposal, which would have required the dissident to solicit only at least a majority of such shareholders.

The dissident can choose to use the "notice and access" method to solicit proxies, which requires only mailing a notice of Internet availability and posting the dissident's proxy materials on a website, which is often less expensive than a "full set delivery" of paper proxy materials using the postal service. Historically, dissident shareholders have not used "notice and access" and have opted for "full set delivery" in contested solicitations for strategic reasons.

Notice to the Company and SEC Filing Requirements. The universal proxy rules provide timing and notice requirements that are new and specific to a contested proxy solicitation. The universal proxy rules prohibit dissidents who do not satisfy these requirements from using a universal proxy card and continuing its proxy solicitation.

A dissident shareholder's obligation to comply with the notice requirement under Rule 14a-19 is in addition to its obligation to comply with any advance notice provisions in a company's governing documents that provide more specific requirements regarding the timing and content of a dissident shareholder's notice of director nominations.

The dissident's principal notice and filing requirements are summarized below.

- The dissident must provide the company with notice of the names of each of the dissident's nominees unless the dissident has previously filed a preliminary or definitive proxy statement naming the nominees. The notice must be postmarked or transmitted electronically to the company at its principal executive office not later than 60 calendar-days before the anniversary of the date of the company's annual shareholder meeting in the previous year, except that if the company did not hold an annual meeting during the previous year, or if the date of the meeting has changed by more than 30 calendar-days from the previous year, then the dissident must provide this notice by the later of 60 calendar-days before the date of the annual meeting or the 10th calendar-day following the day on which the company first publicly announced the date of the annual meeting.

- The dissident must promptly notify the company if there is any change in the dissident's intent to solicit the holders of shares representing at least 67 percent of the voting power of shares entitled to vote on the election of directors in support of the dissident's director nominees or with respect to the names of the dissident's nominees. If there is a change in the company's nominees after the dissident has disseminated a universal proxy card, the dissident could elect, but would not be required, to disseminate a new universal proxy card reflecting the change in the company's nominees.

- The dissident must file a definitive proxy statement with the SEC by the later of 25 calendar-days before the date of the shareholder meeting or five calendar-days after the date that the company files its definitive proxy statement.

Reference to Company Proxy Statement. New Item 7(h) of Schedule 14A requires the dissident to include a statement in its proxy statement referring shareholders to the company's proxy statement for information about the company's nominees. The statement must explain to shareholders that they can access the company's proxy statement, and any other relevant documents, without cost on the SEC website. The company is subject to an identical requirement in the event of a universal proxy solicitation by a dissident.

Under amended Rule 14a-5(c), the company and dissident will be able to satisfy certain disclosure obligations by referring to information that is already, or will be, furnished by another party in its proxy statement. Currently, as written, Rule 14a-5(c) permits parties to refer to information that has been previously furnished, but in a universal proxy system, this could prevent a company from relying on Rule 14a-5(c) to omit required information by referencing the dissident proxy statement where the dissident proxy statement is still to be filed.

The new rules, therefore, amend Rule 14a-5(c) to clarify that a party can rely on the rule to reference information that is reasonably expected to be filed in an upcoming proxy statement of the other party.

Company Notice and Filing Requirements. The universal proxy rules require the company to provide similar notice to the dissident on a similar timetable, except that the company's notice to the dissident containing the names of the company's nominees must be provided not later than 50 days before the anniversary of the date of the company's annual shareholder meeting in the previous year, which is only 10 calendar-days after the dissident's notice to the company has been postmarked or transmitted electronically to the company. This notice deadline is

Due date	Action required
No later than 60 calendar-days before the anniversary of the previous year's annual meeting date or, if the company did not hold an annual meeting during the previous year, or if the date of the meeting has changed by more than 30 calendar-days from the previous year, by the later of 60 calendar-days prior to the date of the annual meeting or the 10th calendar-day following the day on which public announcement of the date of the annual meeting is first made by the company. [new Rule 14a-19(b)(1)]	Dissident must provide notice to the company of its intent to solicit the holders of at least 67 percent of the voting power of shares entitled to vote on the election of directors in support of director nominees other than the company's nominees and include the names of those nominees.
No later than 50 calendar-days before the anniversary of the previous year's annual meeting date or, if the company did not hold an annual meeting during the previous year, or if the date of the meeting has changed by more than 30 calendar-days from the previous year, no later than 50 calendar-days prior to the date of the annual meeting. [new Rule 14a-19(d)]	Company must notify the dissident of the names of the company's nominees.
No later than 20 business-days before the record date for the meeting. [existing Rule 14a-13]	Company must conduct broker searches to determine the number of copies of proxy materials necessary to supply such material to beneficial owners.
By the later of 25 calendar-days before the meeting date or five calendar-days after the company files its definitive proxy statement. [new Rule 14a-19(a)(2)]	Dissident must file its definitive proxy statement with the Commission.

subject to the same exceptions that apply to the dissident's notice.

As noted above, new Rule 14a-5(e)(4) requires a company to disclose the deadline for shareholders to give timely notice to the company of dissident nominations for inclusion on a universal proxy card in connection with the next annual meeting in its annual proxy statement, regardless of whether such meeting is expected to be the subject of a contested solicitation.

The table below, reproduced from the SEC's adopting release, summarizes the overall timetable for a typical universal proxy solicitation.

SEC Proposes Broad Amendments to Longstanding Rule 10b5-1 Protections

By Robert B. Robbins, Bruce A. Ericson, David Oliwenstein, Eugenie Dubin

On December 15, 2021, the Securities and Exchange Commission (SEC) proposed changes to Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) that aim to heighten the requirements to successfully invoke the rule's affirmative defense and create greater transparency around trades executed pursuant to Rule 10b5-1 trading arrangements.

The proposed amendments, which Chair Gensler previewed earlier in 2021, come in the wake of long-standing concerns raised by Members of Congress, courts, scholars, and other commentators regarding executives' stock transactions or company share buy-backs executed before material public announcements, and concerns regarding perceived loopholes in the rule's requirements.[1] This article provides an overview of the current requirements to invoke Rule 10b5-1(c)'s affirmative defense to an insider trading charge, followed by an analysis of the SEC's proposed amendment, and then concludes with a discussion regarding potential risk-mitigation measures that participants in Rule 10b5-1 plans should consider.

Current Requirements to Invoke the Rule 10b5-1 Affirmative Defense

Because the federal securities laws do not specify the elements of insider trading, liability for trading on the basis of material non-public information is generally premised on violations of the antifraud provisions of the Exchange Act (i.e., Section 10(b) and Rule 10b-5 thereunder). In 2000, in an attempt to provide greater clarity regarding the scope of insider trading prohibitions, the SEC adopted Rule 10b5-1, which provides that a person trades "on the basis of" material non-public information "if the person making the purchase or sale was aware of the material non-public information when the person made the purchase or sale."

The rule also provides an affirmative defense to liability when a trade was executed pursuant to a written plan or binding contract adopted when the trader was not aware of material non-public information. The plan must specify the amount, price, and timing of the trade, and be insulated from any further influence by the trader (although the current version of Rule 10b5-1 places no explicit limitation on the cancellation of trading plans). To qualify for the rule's affirmative defense, the trader must strictly comply with these requirements and enter into the trading arrangement "in good faith and not as part of a plan or scheme to evade the prohibitions." Rule 10b5-1(c)(1)(ii).

Although Rule 10b5-1 plans are often associated with corporate officers and directors, the affirmative defense is actually available to any person or entity that complies with the rule's elements, including private equity funds and investment managers. Additionally, the rule's protections extend to all types of securities (i.e., beyond equities) and are not limited to publicly traded securities.

Proposed Amendments to Address Perceived Gaps

The proposed amendments are designed to address long-standing concerns that Rule 10b5-1 plans enable individuals to trade on the basis of material non-public information. If enacted,

 Robert B. Robbins and Bruce A. Ericson are Partners, David Oliwenstein is Counsel, and Eugenie Dubin is a Senior Law Clerk, with Pillsbury Winthrop Shaw Pittman LLP.

the amendments would restrict the availability of the rule's affirmative defense by imposing a cooling-off period following the adoption or modification of a plan, prohibiting overlapping trading plans, and limiting single-trade plans to one trading plan per 12-month period. The proposed rules would also impose a certification requirement on officers and directors, requiring insiders to affirm that they were not aware of material non-public information at the time of a plan's adoption.

Cooling-Off Periods for Directors, Officers, and Issuers

First, as a condition for directors and officers to invoke the rule's affirmative defense, the SEC has proposed a 120-day cooling-off period after adoption or modification of any Rule 10b5-1 plan by a director or officer of the company. Under the SEC's proposal, no trading could occur under any trading arrangement until 120 days following the date of adoption of the plan or modification.

According to the SEC's release, this cooling-off period is designed to prevent insiders from trading on material non-public information regarding quarterly earnings announcements because the 120-day restriction would effectively prohibit trading prior to those announcements. Relatedly, the SEC has proposed a 30-day cooling-off period after the date of adoption of trading arrangements by an issuer before the issuer may purchase or sell any securities under the new or modified plan. According to the SEC's proposing release, a cooling-off period would prevent issuers from conducting stock buybacks while in possession of material non-public information.

What constitutes a "modification" to an existing plan was not fleshed out in the SEC's proposal, but we advise plan participants to construe the term broadly. The SEC's proposal noted that even the cancellation of a single trade under a Rule 10b5-1 plan constitutes a modification, triggering the cooling-off period.

Under the SEC's proposal, the cooling-off period requirements are limited to directors, officers, and issuers based on the rationale that classical "insiders" are more likely to have access to unreleased earnings than other market participants. However, there is the potential for expansion of the proposed amendment's applicability as the SEC requested comments regarding whether the cooling-off period should apply to all traders who rely on the Rule 10b5-1(c)(1) affirmative defense. We expect that the Commissioners and the staff will pay careful attention to any comments received regarding whether a cooling-off period should apply to a broader set of traders.

While cooling-off periods are considered a "best practice" and are common among public companies that have policies governing 10b5-1 trading plans, the proposed 120-day cooling off period is significantly longer than the periods that most companies currently impose. Because many companies discourage or prohibit modification of plans and consider modifications to be equivalent to adoption of a new plan requiring imposition of a new cooling off period, the SEC's proposal should not have much effect on current common "best practice."

Prohibition Against Overlapping Plans and Single Trade Arrangements

Currently, the affirmative defense provided by Rule 10b5-1(c) is only available if the purchases or sales at issue are made pursuant to a contract, instruction, or plan. Rule 10b5-1(c)(1) provides that a transaction is not effected pursuant to a contract, instruction, or plan if the trader entered into a corresponding hedging transaction with respect to the securities subject to the plan. The proposed amendments would expand the prohibition against hedges to include barring the use of multiple plans to time different trades around the release of material non-public information with the idea that once the trader knows the material non-public information he or she would cancel whichever plan likely will result in the less favorable trade.

In other words, the affirmative defense would not be available when a trader maintains another trading arrangement, or subsequently enters into an overlapping trading arrangement for open market purchases or sales of the same class of securities. The proposing release indicates that this prohibition would not apply to transactions directly with the issuer (e.g., employee stock ownership plans). We note that many companies currently prohibit multiple plans, and so the SEC's proposal would in essence codify a recommended "best practice."

For trading plans designed to cover a single trade, the SEC proposed limiting the availability of the affirmative defense to one single-trade plan per 12-month period. The affirmative defense would not apply to a single-trade plan if the trader had purchased or sold securities pursuant to another single-trade plan within the last 12 months. The SEC has long considered plans that entail a single trade to be potentially indicative of misconduct, and the proposed amendment would strike a balance between banning such plans outright and allowing market participants to continue to use a perceived "loophole" to engage in opportunistic trading.

The SEC's proposing release does not contain a definition of "single-trade" plan. Although many traders may construe the phrase to include only ordinary limit orders, market participants that comment on the proposed amendments should consider providing the SEC with feedback regarding the scope of a "single trade" (e.g., whether a series of related acquisitions or divestitures could constitute a "single trade").

Director and Officer Certification

The SEC has also proposed a requirement that, upon adoption or modification of a trading arrangement, directors and officers certify in writing that they are not aware of material non-public information about the issuer or its securities, and that they are adopting the plan in good faith and not to evade securities laws. The proposed amendment would impose a ten-year record retention requirement for any director or officer who seeks to rely on Rule 10b5-1's affirmative defense.

The SEC has also indicated that the proposed certification would not be an independent basis of liability under Section 10(b) and Rule 10b-5, but would instead serve to "underscore the certifiers' awareness of their legal obligations under the federal securities law related to the trading in the issuer's securities." Officers and directors should note that even if the proposed certification does not provide for liability under the anti-fraud provisions, filing false certifications could constitute a violation of the book-and-records provisions of the Exchange Act.

Proposed Enhanced Disclosure Requirements

Currently, with the exception of Form 144's requirement that sellers disclose the date on which a Rule 10b5-1 plan was adopted, there are no mandatory disclosure obligations regarding the use of Rule 10b5-1 trading arrangements. The SEC has made several proposals to address this reporting gap in an effort to minimize the information asymmetry between ordinary investors and company insiders. First, the proposed rules would require that issuers disclose in their Form 10-Qs the existence of all Rule 10b5-1 plans and other related trading arrangements with officers, directors, or the company itself, including information regarding their adoption, modification, and termination.

Relatedly, under the SEC's proposal, issuers will be required to annually disclose their insider trading policies in their Form 10-Ks or Form 20-Fs, as applicable. If an issuer has not adopted an insider trading policy, it will be required to explain why it has not done so. The proposed amendments would require issuers to disclose in their Form 10-Ks, as well as proxy statements and statements related to the election of directors and executive compensation, stock option and stock appreciation awards made within two weeks of the public announcement of any material non-public information.

The amendments would also require that issuers disclose the details of the options (including amount, fair value, and price of the underlying securities), and the market price of the underlying securities the trading day before and after disclosure of the material non-public information.

On Form 4 and Form 5, which must be completed by principal shareholders (i.e., any person or entity that directly or indirectly owns more than ten percent of a class of registered equity securities) in addition to corporate directors and officers, the SEC proposed the addition of a check box by which filers must indicate whether a transaction reported was made pursuant to a trading plan. We note that this requirement comports with current industry best practices and is also required by many broker-dealers that administer Rule 10b5-1 plans. In addition, under the SEC's proposal, *bona fide* gifts of securities will no longer be reported on Form 5, but will be required to be reported on Form 4, before the end of the second business day following the date of the gift.

Risk Mitigation Measures

Even prior to the announcement of the proposed amendments to Rule 10b5-1, Chair Gensler had indicated that Rule 10b5-1 plans and insider trading, generally, would be regulatory and enforcement priorities of the SEC under his leadership. It is also worth noting that the SEC's proposed amendments have unanimous support from its five Commissioners, a majority of whom the prior presidential administration appointed.

For these reasons, and in light of the overall aggressive enforcement climate under Chair Gensler, participants in Rule 10b5-1 trading plans should consider proactive risk mitigation measures, including implementing the substance of the SEC's proposed amendments before the SEC decides whether to approve them.

As an initial matter, it is worth reiterating that, in order to invoke the protections of Rule 10b5-1's affirmative defense, a trader must comply strictly with all elements of the rule. Accordingly, market participants should review their policies and procedures regarding trading arrangements to ensure that any plans—and the processes for adopting and modifying any plan—satisfy every requirement under Rule 10b5-1(c).

Officers and directors of issuers generally rely on counsel to oversee compliance with Rule 10b5-1 and the creation and modification of Rule 10b5-1 plans. Other traders that avail themselves of the rule's protection should likewise ensure that counsel or compliance personnel are involved at all stages of the process. Relatedly, private equity funds that utilize Rule 10b5-1 plans should work with compliance and legal to evaluate how the proposed prohibition against overlapping trading arrangements will affect their trading strategies.

Mindful that regulated entities have a duty to reasonably supervise their personnel with an eye toward preventing and detecting potential misuse of material non-public information, investment firms should evaluate their compliance with Rule 10b5-1 in the context of their broader efforts to comply with insider trading prohibitions. Investment advisers should use this as an opportunity to review their policies, procedures, systems, and controls with respect to insider trading generally. In light of the unique risks posed by Rule 10b5-1 plans and the associated evolving regulatory requirements, regulated entities should consider providing mandatory training for any associated or registered personnel intending to utilize a trading arrangement.

Finally, regulated entities should pay careful attention to the duration and scope of any plans. The SEC's proposing release suggests that the agency views relatively short plans with considerable skepticism, and such plans could be perceived as an attempt to circumvent Rule 10b5-1's requirements. Market participants should also be judicious in their use of Rule 10b5-1 plans. Trading plans should only include securities for which there is a reasonable likelihood that the participant will acquire confidential information. In the case of private funds, plans should likely cover the securities of portfolio companies.

The SEC has provided a 45-day comment period for the proposed amendments, a relatively brief window given the complex and important issues raised by the proposal. Market participants—including both classical "insiders" and other traders—that rely on Rule 10b5-1 plans should strongly consider sharing their perspectives with the SEC as the agency sets the ground rules that will apply to these trading arrangements.

Note

1. *https://www.sec.gov/news/press-release/2021-256*.

SEC Proposes to Rescind Recently Adopted Proxy Voting Advice Rules

By Christina Thomas and Laura Richman

The Securities and Exchange Commission (the "SEC" or the "Commission") proposed changes to the proxy solicitation rules on November 17, 2021. The proposed changes would rescind certain new rules adopted by the SEC in July 2020 (the Adopted Rules) that apply to proxy voting advice produced and disseminated by proxy advisory firms, otherwise known as proxy voting advisory businesses (PVABs).

Background

PVABs, such as Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co., using their own benchmark recommendations or tailoring recommendations to a particular client's request, provide advice to asset manager clients on how to vote on matters at public company shareholder meetings. In addition, some PVABs provide electronic platforms that not only deliver that advice, but also pre-populate client ballots for each applicable shareholder meeting and submit those votes to be counted (either after client review or automatically as soon as the recommendations are generated on the platforms).

This advice and the vote submission service are valuable to the PVABs' clients, given that many asset managers invest in hundreds, if not thousands, of companies, many of which hold their annual shareholders' meetings during the same time frame each year.

PVABs have historically been unregulated but are believed to influence a significant portion of shareholder votes on any given matter presented by a company or one of its shareholders. During the last administration, the SEC tackled the controversial issue of PVAB influence over proxy voting by revising the proxy solicitation rules to require that PVABs base their proxy voting advice on the most accurate information reasonably available and that PVABs be transparent regarding their conflicts of interest and the methodologies used to formulate their advice.

The Adopted Rules:

- amended Rule 14a-1(l) to codify the SEC's long-standing position that voting advice provided by PVABs generally constitutes a solicitation under the proxy rules;
- amended Rule 14a-2(b) to add the following principles-based conditions to the exemptions to the information and filing requirements of the proxy rules that PVABs have historically relied on:
  - PVABs must disclose conflicts of interest to their clients in their proxy voting advice or in the electronic medium used to deliver that advice;
  - PVABs must establish procedures designed to allow all companies that are the subject of PVAB voting advice to have access to that advice in a timely manner; and
  - PVABs must provide a mechanism for their clients to become aware of any written company response to their voting advice on a timely basis before they vote; and
- added to the examples of misleading information in Rule 14a-9 to make clear that the failure to disclose material information regarding proxy voting advice, such as a PVAB's methodology, sources of information, or conflicts of interest, could cause such advice to be misleading in violation of the proxy rules.

Christina Thomas is a Partner, and Laura Richman is Counsel, of Mayer Brown LLP.

The adoption of these rules was not without controversy. ISS, possibly the largest PVAB subject to the Final Rules, filed a lawsuit against the SEC, challenging the Adopted Rules, as well as related Commission guidance. The amendments to Rules 14a-1(l) and 14a-9 became effective on November 2, 2020, although those revisions did not create any new obligations. Compliance with the conditions in Rule 14a-2(b) was not required until December 1, 2021.

Upon taking office, SEC Chair Gensler directed the Staff to consider whether to recommend revising the Adopted Rules. On June 1, 2021, the SEC Staff published a statement announcing that it would not enforce the Adopted Rules or related guidance. The National Association of Manufacturers has since sued the SEC alleging a violation of the Administrative Procedure Act for refusing to enforce the Adopted Rules.

Proposal

On November 17, 2021, the Commission voted to propose to rescind certain of the Adopted Rules. Specifically, the Commission proposes to rescind the condition that would require PVABs to provide their proxy voting advice to subject companies and the condition that would require PVABs to alert their clients to any company response.

In addition, the Commission voted to remove the example from Rule 14a-9, while affirming in the proposing release that a "PVAB, like any other person engaged in solicitation, may, depending on the facts and circumstances, be subject to liability under Rule 14a-9 for a materially misleading statement or omission of fact, including with regard to its methodology, sources of information or conflicts of interest." The press release announcing the action explained the current Commission's view that the Adopted Rules "may impede and impair the timeliness and independence of proxy voting advice and subject proxy voting advice businesses to undue litigation risks and compliance costs."

Practical Considerations

The treatment of proxy voting advice for the purposes of proxy rules is a complex issue with divergent, and often-competing, views coming from various perspectives. However, proxy voting advice can influence proxy voting outcomes. Therefore, companies and other participants in the proxy process should monitor the proposal closely.

The public had until December 27, 2021, to comment on the proposal. These proposed revisions, if adopted, are expected to have limited practical effect on the way in which PVABs are now doing business, because the rules proposed to be rescinded are not being enforced by the SEC.

Notably, the SEC did not propose to rescind the amendment that codified the definitions of the terms "solicit" and "solicitation" as including proxy voting advice. As a result, the proposal, if adopted, would not eliminate the requirement for PVABs, depending upon particular facts and circumstances, to disclose conflicts of interest. Therefore, to the extent any PVABs do not do so already, they may need to provide, or enhance the presentation of, conflict of interest information for their clients.

ENDNOTES

1 Available at *https://www.mayerbrown.com/-/media/files/perspectives-events/publications/202%7/sec-adopts-proxy-voting-advice-rule-amendments.pdf*.

the Corporate Governance advisor

EDITOR-IN-CHIEF
Broc Romanek
ZippyPoint.com
Arlington, VA
703-475-4257
<broc@zippypoint.com>

PUBLISHER
Richard Rubin

MARKETING MANAGER
Steven Santel

WOLTERS KLUWER

28 Liberty Street
New York, NY 10005
212-771-0600

Wolters Kluwer

Wolters Kluwer
The Corporate Governance Advisor
Distribution Center
7201 McKinney Circle
Frederick, MD 21704

March/April 10041526-0320