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Legal Update

SEC Votes on Changes to Shareholder Proposal and Proxy Solicitation Rules

Shareholder Proposal Rule

On July 13, 2022, the US Securities and Exchange Commission (the "SEC") proposed amendments to revise three of the substantive bases for exclusion of shareholder proposals under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the "Proposed Rules").[1] Specifically, the Proposed Rules would amend the following bases for exclusion: substantial implementation (Rule 14a-8(i)(10)); duplication (Rule 14a-8(i)(11)); and resubmission (Rule 14a-8(i)(12)).

According to the proposing release, the Proposed Rules are intended to provide greater certainty and transparency in the application of the exclusionary rules and to facilitate shareholder suffrage and communication between shareholders and companies.

Substantial Implementation. Currently, Rule 14a-8(i)(10) allows a shareholder proposal to be excluded from a company's proxy statement if the company "has already substantially implemented the proposal." The Proposed Rules set forth a new test to determine whether a proposal has been substantially implemented by the company: a proposal may be excluded "[i]f the company has already implemented the essential elements of the proposal."

To determine the essential elements of the proposal, the release suggests that the level of specificity and the stated objectives of the proposal would guide the analysis. Next, in order to exclude the proposal, the company must show that it has already implemented each of the essential elements. A proposal may be excluded where the differences between the company's implementation and the proposal "are not essential to the proposal."[2]

Duplication. Rule 14a-8(i)(11) currently provides that a shareholder proposal may be excluded if it substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting. The proposed amendment to Rule 14a-8(i)(11) would specify that substantially duplicates means that a proposal "addresses the same subject matter and seeks the same objective by the same means" as a previously submitted proposal. Currently, analysis under Rule 14a-8(i)(11) hinges on whether the proposals share the same "principal thrust" or "principal focus," which the SEC indicated can necessitate fact-intensive, case-by-case judgments.

The proposed amendment would allow shareholders to submit proposals that may be on the same subject matter or address the same substantive concerns but utilize different means or methods to be included in the

proxy statement. According to the proposing release, the SEC believes the proposed amendment "would provide a clearer standard for exclusion, assist the staff in more efficiently reviewing and responding to no-action requests, and benefit shareholders and companies by promoting more consistent and predictable determinations regarding the exclusion of proposals."[3]

Resubmission. As currently in effect, Rule 14a-8(i)(12) allows a proposal to be excluded if it addresses substantially the same subject matter as a proposal, or proposals, previously included in the company's proxy materials if certain approval thresholds are met. The proposed amendments to Rule 14a-8(i)(12) would change the "addresses substantially" standard to "substantially duplicates" and specify that "substantially duplicates" means that another proposal "addresses the same subject matter and seeks the same objective by the same means." As such, a proposal may only be excluded if both the subject matter and the means of a proposal are the same as a shareholder proposal that was previously submitted. The proposed amendments to Rule 14a-8(i)(12) align the standard for exclusion with the proposed standard under 14a-8(i)(11).

Examples. The release sets forth examples of how the applications of the Proposed Rules would differ from current application of the rules. Under Rule 14a-8(i)(10) as proposed, a company with a proxy access provision that permits a group of up to 20 shareholders owning 3% of its common stock to nominate directors would no longer be able to exclude on the basis of substantial implementation a shareholder proposal seeking a proxy access provision allowing an unlimited number of shareholders owning 3% of its common stock to nominate directors because the ability of an unlimited number of shareholders to aggregate shareholdings to form a nominating group generally would be an essential element of the proposal. Similarly, a shareholder proposal seeking a report from the board of directors on a certain topic would be not be excludable on the basis of substantial implementation if management had published a report on the same topic. Additionally, if the company's current report or disclosure on the topic does not implement the essential elements of the proposal or the proposal explains the insufficiencies of the company's current report or disclosures, the proposal would not be excludable under Rule 14a-8(i)(10) as proposed.

The illustrative example for the proposed changes to Rule 14a-8(i)(11) compares two shareholder proposals related to the company's political contributions and lobbying activities, which would be deemed to have the same "principal thrust" under the rule as currently in effect. However, proposal one requests that a detailed summary be published in the newspaper setting forth the company's political contributions and lobbying activity, while proposal two requests a report to shareholders on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities. Under the Proposed Rules, neither proposal may be excluded on the grounds that it duplicates the other because each proposal seeks different objectives by different means.

The example provided for the application of Rule 14a-8(i)(12) as proposed compares a shareholder proposal requesting that the board adopt a policy prohibiting the vesting of government service golden parachutes with a proposal requesting that a report be prepared on the vesting of government service golden parachutes setting forth eligible individuals and the estimated dollar value of each potential government service golden parachute. While both proposals address government service golden parachutes, neither may be excluded as a resubmission of the other proposal because the proposals do not seek the same objectives by the same means.

In addition to setting forth the Proposed Rules, the release "reaffirmed" the standards of Rule 14a-8(i)(7), the ordinary business exclusion, citing language in the rule's 1998 adopting release relating to significant social policy issues and micromanagement. This reference seems out of place in a proposing release that does not propose changes to Rule 14a-8(i)(7), and so could be interpreted as the SEC affirming the staff guidance in Staff Legal Bulletin No. 14L,[4] which the staff published to, among other things, explain its change in approach to the application of Rule 14a-8(i)(7). For a summary of Staff Legal Bulletin No. 14L, please see our legal update.

The public comment period will remain open until September 12, 2022 or thirty (30) days following publication of the proposing release in the *Federal Register*, whichever is longer.

Proxy Voting Advice Amendments

In July 2020, the SEC adopted amendments applicable to proxy voting advice produced and disseminated by proxy advisory firms. However, in November 2021, the SEC proposed rescinding key aspects of those 2020 amendments, which it did on July 13, 2022. Specifically, the SEC rescinded the condition to the availability of certain exemptions from the information and filing requirements of the federal proxy rules for proxy voting advice businesses. In addition, the SEC deleted a note to Rule 14a-9 that provided examples of situations in which the failure to disclose certain information in proxy voting advice may be considered misleading within the meaning of the federal proxy rules' prohibition on material misstatements or omissions.

Practical Considerations

The proposed amendments to Rule 14a-8, if adopted, would have the effect of allowing a greater number of shareholder proposals to be included in company proxy statements because the amendments would revise the rules to make it more difficult for companies to establish each of the bases. Fewer shareholder proposals would be excludable, and we are likely to see instances of conflicting and duplicative proposals on the ballot. This could result in confusion when shareholders are asked to vote on different proposals on similar topics *and* when companies attempt to implement proposals in a manner that is responsive to shareholders.

It is not clear at this point whether the SEC intends to adopt the Proposed Rules before the next proxy season, but companies should be prepared for the SEC staff to interpret Rules 14a-8(i)(10), (i)(11), and (i)(12) more strictly during the 2023 proxy season.

Because the Proposed Rules could dramatically impact shareholder proposals submitted for inclusion in company proxy statements, interested parties should consider sending comments on the Proposed Rules to the SEC during the short comment period that has been provided.

The SEC's action with respect to proxy advisory firms is unlikely to result in any changes during the 2023 proxy season. The SEC essentially removed the teeth from the rules adopted in 2020 and, as a result, public companies can no longer expect the opportunity to review proxy voting advice reports sent to their investors or ensure that proxy advisory firm clients are made aware of company responses to those reports.

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Endnotes

[1] Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals Under Exchange Act Rule 14a-8, Exchange Act Release No. 34-95267 (Jul. 13, 2022), *available at* https://www.sec.gov/rules/proposed/2022/34-95267.pdf.

[2] *Id*. at 15.

[3] *Id*. at 19.

[4] Staff Legal Bulletin No. 14L (Nov. 3, 2021), *available at* https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals.