SEC Proposes Amendments to the Shareholder Proposal Rules

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This client alert has been updated to specify that comments were due by September 12, 2022.

On July 13, 2022, the U.S. Securities and Exchange Commission (SEC), by a 3-2 vote, proposed amendments to the proxy rules that would narrow certain grounds under which companies may exclude shareholder proposals from their proxy statements. Specifically, the proposed amendments would modify the standards for exclusion under the "substantial implementation," the "duplication" and the "resubmission" bases for exclusion under Rule 14a-8. Although presented as an effort to provide greater certainty and transparency to shareholder proponents and companies, the amendments (if adopted as proposed) likely would increase the number of shareholder proposals received by companies and make it less likely that proposals could be excluded.

Comments on the proposal were due by September 12, 2022. As the amendments are proposed rather than final rules, companies currently receiving shareholder proposals should continue to analyze those proposals under the existing rules.

Background

Pursuant to Rule 14a-8, a company must include a shareholder proposal in the company's proxy materials unless the proposal falls under any one of thirteen substantive bases for exclusion or the proponent or proposal fails to satisfy the eligibility or procedural requirements of the rule. When a company intends to exclude a shareholder proposal from its proxy materials, the company typically requests no-action relief from the Staff of the SEC's Division of Corporation Finance (Staff).

As described in our June 2022 Insights article, the Staff took a number of positions during the 2022 proxy season that overturned long-standing no-action letter precedent. The proposed amendments would codify some of those positions and narrow three of the substantive bases available to companies to exclude proposals.

Proposed Amendments

Substantial Implementation: Currently, Rule 14a-8(i)(10) allows a company to exclude a shareholder proposal that "the company has already substantially implemented." In determining whether a proposal has been substantially implemented, the Staff assesses whether a company's particular policies, practices and procedures "compare favorably" with the guidelines of the proposal. The Staff also considers whether the company has addressed the proposal's underlying concerns and whether the essential objectives of the proposal have been met. Historically, a proposal could be excluded on the basis of substantial implementation even if a company had not implemented all of the proposal's requested elements.

In contrast, prior to 1983, exclusion was available only when a company had "fully effected" the proposal. In a number of instances in the 2022 proxy season, the Staff appeared to apply a test closer to "total implementation" than "substantial implementation."

The proposed amendment would provide that a company may exclude a proposal as substantially implemented "[i]f the company has already implemented the essential elements of the proposal." In particular, the proposing release notes that the proposed amendment would permit a shareholder proposal to be excluded as substantially implemented only if the company has implemented *all* of its essential elements.

In addition, the proposing release states that "the degree of specificity of the proposal and any of its stated primary objectives" would guide the determination of which elements of a proposal are "essential elements" (with the caveat that as the proponent identifies more elements, each becomes less essential).

Illustrating the difference in approach from the current rule, the proposing release notes that the Staff historically found that proposals seeking the adoption of proxy access provisions that allowed an unlimited number of shareholders who collectively have owned 3% of the company's outstanding common stock for three years to nominate up to 25% of the company's directors have been deemed substantially implemented where the company adopted a proxy access bylaw allowing a shareholder or group of up to 20 shareholders owning three 3% of its common stock continuously for three years to nominate up to 20% of the board. Under the proposed amendment (as well as no-action letters in the 2022 proxy season), inclusion of a proxy access aggregation limit would preclude a finding of substantial implementation. Another illustration provided in the proposing release indicates that, in certain circumstances, a proposal seeking a report from a company's board of directors may not be substantially implemented if the report comes from company management.

Duplication: Currently, Rule 14a-8(i)(11) provides that a company may exclude a shareholder proposal if the proposal "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." As the SEC explained when it adopted the exclusion in 1976, "[t]he purpose of the provision is to eliminate the possibility of shareholders having to consider two or more substantially identical proposals submitted to an issuer by proponents acting independently of each other."

In evaluating whether proposals are substantially duplicative under Rule 14a-8(i)(11), the Staff historically has considered whether the proposals share the same "principal thrust" or "principal focus." Proposals that differ in terms or scope may nevertheless be deemed substantially duplicative if the principal thrust or focus is the same.

The proposed amendment would specify that a proposal "substantially duplicates" another proposal previously submitted for the same shareholder meeting if it "addresses the same subject matter and seeks the same objective by the same means."

As described in the proposing release, the amendment would "facilitate the consideration at the same shareholder meeting of multiple shareholder proposals that present different means to address a particular issue."

At the same time, the proposing release recognizes that the proposed amendment could result in shareholder confusion and create implementation challenges for companies if shareholders approve multiple similar, but not duplicative, proposals.

Resubmission: Currently, Rule 14a-8(i)(12) provides that a company may exclude a shareholder proposal from the company's proxy materials if the proposal "addresses substantially the same subject matter as a proposal, or proposals, previously included in the company's proxy materials within the preceding five calendar years" if the matter was voted on at least once in the last three years and received support below certain specified thresholds on the most recent vote. Those quantitative thresholds were amended in 2020 and became effective for the 2022 proxy season (and would remain unchanged under the proposed amendments).

Under the current resubmission basis for exclusion, a proposal may be found to deal with "substantially the same subject matter" as a previous proposal when it shares the same "substantive concerns." In conducting this analysis, the Staff does not focus on the "specific language or actions proposed to deal with those concerns."

The proposed amendment would provide that a proposal qualifies as a resubmission if it "substantially duplicates" another proposal that was previously submitted for the same company's prior shareholder meetings, meaning that it "addresses the same subject matter and seeks the same objective by the same means."

Conclusion

When the eligibility and resubmission thresholds under Rule 14a-8 were amended in 2020, the shareholder proponent community expressed serious concerns. As those rules became effective for the 2022 proxy season, the amendments, in reality, had minimal impact and, in fact, the number of shareholder proposals reached levels not seen since 2016. In contrast, the current proposed amendments, if adopted, create a clear road map for proponents to submit multiple proposals on the same topic in a single year and to submit proposals on topics that a company has previously acted upon or that failed to achieve meaningful shareholder support, in each case with no likely recourse for companies to exclude those proposals. As a result of the likely increase in the number of shareholder proposals submitted to companies and requiring a vote at annual meetings, adoption of the rules as proposed could have the unintended consequence of reducing meaningful engagement between companies and shareholders, to the detriment of all parties.

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More information on the proposed amendments to the shareholder proposal rule is available in the SEC's proposing release and accompanying press release.

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