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SEC proposes to substantially restrict grounds for excluding shareholder proposals

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The proposal would significantly narrow the likelihood of obtaining no-action relief from the SEC on shareholder proposals, leading to a potential flood of additional proposals on ballots.

On July 13, 2022, the Securities and Exchange Commission issued a proposal which would amend three substantive bases for excluding shareholder proposals: the substantial implementation exclusion, the duplication exclusion and the resubmission exclusion. What may appear fairly benign in terms of the proposed textual changes to Rule 14a-8 underlies a fairly dramatic departure from existing practice. Consistent with the fallout from recent SEC staff guidance under SLB 14L and many of the unexpected staff decisions that occurred during the 2022 proxy season, the proposal will shift the balance fundamentally in favor of what the SEC calls "shareholder suffrage." The proposal would not affect foreign private issuers who are not subject to U.S. proxy rules.

The SEC will be accepting public comments until 30 days after the date of publication in the Federal Register or until September 12, 2022, whichever is later.

Rule 14a-8

Rule 14a-8 under the Securities Exchange Act of 1934 requires public companies to include shareholder proposals in their proxy statements if the proposals meet procedural and substantive requirements. A company may seek no-action relief from the SEC staff to exclude a proposal on multiple grounds. The proposal would affect three of the substantive bases that companies use to argue for exclusion, in an effort, according to the SEC, to provide increased consistency and predictability to the process.

A foreshadowing of the proposal was evident in this past proxy season, as the SEC staff made multiple determinations that appeared to be inconsistent with prior no-action letters and ultimately reversed many long-standing precedents, although under numerous bases and not just those contained in the proposal. The upshot was that companies were able to exclude proposals much less frequently than in prior seasons, resulting in a significant uptick in the number of proposals placed on corporate ballots.

The proposal leaves intact, at least for now, the Rule 14a-8 amendments made in September 2020 that strengthened some of the procedural requirements needed for submission, including more meaningful ownership thresholds. The proposal also does not address the ordinary business exclusion, although this exclusion has already been narrowed by the guidance in SLB 14L.

Substantial implementation

Current. Rule 14a-8(i)(10) permits a company to exclude a shareholder proposal that the company has already "substantially implemented." In making the determination, the SEC staff previously considered whether the company's

policies, practices and procedures compare favorably with the guidelines of the proposal and whether it addressed the proposal's underlying concerns.

Proposed. The proposal would require that the staff focus instead on the specific elements of a shareholder proposal to assess whether the company's prior actions taken to implement the substance of the proposal are sufficiently responsive. The degree of specificity of the shareholder proposal and its stated primary objectives would guide the analysis, and any differences between the proposal and the company's actions would have to be non-essential to the proposal to meet the standard of substantial implementation.

Impact. The examples provided in the proposal include a proxy access proposal that allows for the ability of an unlimited number of shareholders to form a nominating group. A company that adopts any numerical limit on that group when implementing proxy access would not be able to have the proposal excluded.

Most no-action relief requests arguing substantial implementation are responding to proposals calling for reports, where the company had already addressed the subject matter in a prior report. Going forward, proposals will likely not be excluded if the plain language of the proposal explains how the company's existing reports or disclosures are insufficient. In addition, a proposal that requests a report from the board, such as an assessment by the board or an explanation of the board's process, will not be considered substantially implemented if management provides the report instead.

The consequences of the potential adoption of this element of the proposal were already felt this season, as even without any changes in SEC rules, the staff did not permit the exclusion of proxy access proposals similar to the example noted above, ignoring years of staff decisions to the contrary. The staff also did not adhere to precedent standard in disallowing exclusion for other governance proposals, including proposals to eliminate supermajority vote provisions when a company had previously adopted a "majority of votes outstanding" standard if the proposal called for a "majority of votes cast" standard.

The proposal would make it fairly simple for any proponent to claim that its primary objective is not addressed by a company's existing report on any subject. A proponent could also describe the requested elements of a shareholder proposal in a manner that makes it challenging for a company to argue that it has substantially addressed those elements, such as including somewhat detailed or complex elements.

Duplication

Current. Under current Rule 14a-8(i)(11), the duplication exclusion provides that a company may exclude a shareholder proposal that "substantially duplicates" a shareholder proposal that the company has already received, and will be including on its proxy card for the same meeting. The staff has traditionally considered the second proposal to be duplicative of the first one if the two proposals have the same principal thrust or focus.

Proposed. The SEC believes that it would be appropriate to have multiple competing proposals on the same ballot that address similar issues, and for that reason the proposal would amend the standard so that proposals are duplicative only when they address the same subject matter and seek the same objective by the same means.

Impact. It appears that two proposals must have the same subject, objective and means of implementation for the second one to be excluded. Proposals that cover the same subject but seek different objectives would not be excludable. In the example provided by the proposal, a proposal that asks a company to publish in newspapers a detailed statement of each of its direct or indirect political contributions or attempts to influence legislation and another shareholder proposal requesting a report on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities are not duplicative. Although they both address political and lobbying expenditures, they seek different objectives by different means.

In practice, at least with respect to shareholder proposals focused on political activities, the staff has already decided that proposals that address lobbying activities are different from proposals that address political contributions. This distinction has led to some companies facing multiple proposals on ballots about their public policy and political initiatives. With the proposal, we will likely continue to see multiple proposals that touch on similar or even the same subject matters, especially a proliferation of environmental and social proposals.

The SEC is aware of this possible consequence, and in its request for comments asks two interesting questions around whether there should be a numerical limit on the number of shareholder proposals that address the same subject matter, or whether priority should be given to proponents who own more shares or have amassed a larger group of co-proponents.

Resubmission

Current. The resubmission exclusion under Rule 14a-8(i)(12) allows a company to exclude a shareholder proposal that addresses "substantially the same subject matter" as a proposal previously included in the company's proxy within the preceding five calendar years if the matter was voted on before and received support below specified vote thresholds.

Proposed. The proposal would change the standard for the resubmission exclusion from "substantially the same subject matter" to "substantially duplicates," using the same analysis outlined above.

Impact. The SEC plainly wants to allow proponents who did not get strong support in one year to be able to adjust their proposals in an effort to gain more support, or allow other shareholders to submit similar proposals that seek to address the same issue by alternate means.

The SEC provides as an example that a proposal requesting the board to adopt a policy prohibiting the vesting of a "government service golden parachute" and a proposal requesting the board to prepare a report to shareholders regarding the vesting of such golden parachutes but asks that eligible senior executives and dollar values of the parachutes be identified are not considered duplicative. Therefore, simply asking for a few pieces of additional information from a prior proposal that received a low vote would avoid the resubmission exclusion.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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