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SEC Proposes Changes to Shareholder Proposal Rule

If Adopted, the Proposed Changes Would Limit Exclusion of Shareholder Proposals

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Securities and Capital Markets

On July 13, 2022, the Securities and Exchange Commission (SEC) proposed amendments to the shareholder proposal rule, Rule 14a-8 under the Securities Exchange Act of 1934. If adopted, these changes would narrow the scope of three parts of the rule that companies may utilize to exclude shareholder proposals.

Rule 14a-8 governs the shareholder proposal process. Under the rule, public company shareholders may submit proposals for inclusion in a company's proxy materials. This right is conditional, however. Shareholders and their proposals must satisfy certain procedural and substantive requirements. If a procedural or substantive requirement is not met, a company may exclude the proposal.

The proposed amendments would introduce stricter standards for three of the substantive bases for exclusion under Rule 14a-8: (i) substantial implementation, (ii) duplication, and (iii) resubmission. If these stricter standards are adopted, it will be more challenging for companies to rely upon these bases when seeking no-action relief from the SEC staff to exclude a shareholder proposal.

Below we provide a summary of the proposed amendments, which are subject to a notice and comment period ending on the later of 30 days following publication of the proposal in the Federal Register or September 12, 2022.

1 Substantial Implementation: New Focus on "Essential Elements" of Proposal

Under the "substantial implementation" provision, Rule 14a-8(i)(10), a shareholder proposal may be excluded from a company's proxy materials if the company has already "substantially implemented" the proposal. This provision recognizes that a company's existing policies or actions may render a shareholder proposal moot and therefore serve as an appropriate basis for exclusion of such proposal. The substantial implementation provision is one of the most frequently used bases for exclusion under Rule 14a-8.

The proposed amendments would replace the "substantially implemented" standard with an "essential elements" standard. A company would only be able to exclude a proposal under Rule 14a-8(i)(10) if the company has implemented the essential elements of the proposal. Determining which elements of the proposal are "essential" will be the key consideration, as all of those elements would need to be implemented in order to rely on this basis for exclusion. If a company's actions differ from those requested by the proposal, the company would be permitted to exclude the proposal under the revised standard only as long as the differences are not considered essential to the proposal.

The SEC stated that "the degree of specificity of the proposal" and the "stated primary objectives" outlined in the proposal would guide the staff's analysis of which elements are essential and which are not. The proposal notes that the more elements a proponent identifies, the less essential the staff would view each of those elements.[1]

If the "essential elements" standard is adopted as proposed, the SEC staff will likely expect close adherence to the specific language of the proposal in order for a company to be able to exclude the proposal under Rule 14a-8(i)(10).

Key Takeaway: Proponents Will Likely Determine the Essential Elements

The determination of "essential elements" will vary from proposal to proposal, but the proposed rule suggests there will be greater latitude and deference afforded to proponents to show which elements are essential.

2 Duplication and Resubmission: No Exclusion Unless Same Subject Matter, Objective and Means

Under the duplication provision in Rule 14a-8(i)(11), a 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. Under the resubmission provision in Rule 14a-8(i)(12), a proposal may be excluded if (i) the proposal deals with "substantially the same subject matter" as another proposal (or proposals) last voted on within the preceding three years and (ii) when last voted on, the similar proposal did not reach a certain threshold level of support.[2]

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[1] As an example, the proposal cites so-called "fix it" proxy access proposals seeking to remove a cap on the number of holders who may aggregate their holdings for purposes of making a proxy access nomination as a type of proposal that would no longer be excludable under Rule 14a-8(i)(10). The proposal states that "the ability of an unlimited number of shareholders to aggregate their shareholdings to form a nominating group generally would be an essential element of the proposal."

[2] The relevant level of support varies based on the number of times the proposal has been voted on within the previous five years: 5%, 15%, and 25% of votes cast if voted on once, twice, or three or more times, respectively.

The proposed amendments would change both the "substantially duplicates" standard of the duplication provision and the "substantially the same subject matter" standard of the resubmission provision. Under the revised provisions, both the duplication and resubmission standards would permit exclusion of a shareholder proposal only if it "substantially duplicates (*i.e.*, addresses the *same* subject matter and seeks the *same* objective by the *same* means as)" (emphasis added) a previously submitted shareholder proposal that will be included in the company's proxy materials for the current meeting or that was included and voted upon at a prior meeting. The SEC acknowledged that this standard could result in the inclusion of multiple shareholder proposals in a company's proxy materials that deal with the same or similar issues.[3]

As with the proposed amendments to the substantial implementation provision in Rule 14a-8(i)(10), the amended duplication and resubmission provisions in Rules 14a-8(i)(11) and (i)(12) represent a stricter standard of interpretation and are likely to result in fewer proposals being excluded on these grounds.

3 2020 Amendments to Rule 14a-8 Remain in Effect

Some commentators had expected the proposed amendments to revisit certain procedural requirements and the resubmission thresholds of Rule 14a-8, which the SEC amended in 2020.[4]

The proposed amendments do not address these requirements, which remain in effect. However, the SEC noted in the proposed rule that it "continues to assess the impact of these amendments."

Commentary: Proposal Continues Trend in Favor of Proponents

The proposed amendments follow in the wake of updated SEC staff guidance issued in November 2021, which introduced stricter standards for two other bases for exclusion under Rule 14a-8 — ordinary business operations and economic relevance. Together with that guidance, this SEC proposal, if adopted, would tilt the playing field even further in favor of shareholder proponents.

[3] For example, the proposal cites shareholder proposals that (i) request publication in a newspaper of a detailed statement of each of its direct and indirect political contributions or attempts to influence legislation and (ii) a report to shareholders on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities as examples of proposals that would no longer be deemed substantially duplicative because they "seek different objectives by different means."

[4] The 2020 amendments (i) raised the ownership requirements for proponents, (ii) required enhanced documentation and communication between proponents and companies, (iii) clarified that a shareholder and shareholder representative may submit no more than one proposal for the same shareholder meeting, and (iv) raised the levels of shareholder support a proposal must receive to be eligible for resubmission at a future shareholder meeting.

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