Cahill

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SEC Proposes to Update Certain Substantive Bases for Exclusion of Shareholder Proposals

On July 13, 2022, the Securities and Exchange Commission ("SEC") proposed amendments to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Under Rule 14a-8, reporting companies with securities registered under Section 12 of the Exchange Act must include shareholder proposals made under such rule in their proxy materials unless they can demonstrate either a procedural or a substantive basis for exclusion. The SEC's proposal would amend three of the 13 substantive bases for exclusion: (i) the substantial implementation exclusion, (ii) the duplication exclusion and (iii) the resubmission exclusion. The SEC believes the proposal will facilitate the exercise of shareholders' rights by providing a clearer framework for application of the rule.

I. Substantial Implementation Exclusion

Current Rule 14a-8(i)(10) provides for exclusion of a shareholder proposal from a company's proxy materials where the company already has "substantially implemented" the proposal. During the most recent proxy period, the SEC staff received 110 no-action requests based on this exclusion and granted 36 such requests.[1] Due to the relatively subjective nature of the rule, the SEC historically has applied various interpretive frameworks to determine whether a proposal has been substantially implemented. As a result, some observers have noted that the current rule is difficult to apply with any consistency.

The proposed amendments therefore propose a new test and would specify that a proposal may be excluded under this provision if the company already has implemented the "essential elements" of the proposal. The SEC acknowledged that the proposed rule still would require a fact-intensive analysis. However, it did articulate a few parameters for the proposed "essential elements" test. First, it outlined the structure of the analysis: companies wishing to exclude proposals on this basis must first determine which elements are "essential" and then analyze whether each such element has been addressed. Second, it stated that the determination of which elements are "essential" would be guided by the degree of the proposal's specificity and by its stated primary objectives.

The SEC also provided some illuminating examples of how the test would be applied. For instance, it stated that the staff no longer would concur in the exclusion of proposals "seeking the adoption of a proxy access provision that allows an unlimited number of shareholders who collectively have owned 3 percent of the company's outstanding common stock for 3 years to nominate up to 25 percent of the company's directors, where the company had adopted a proxy access bylaw allowing a shareholder or group of up to 20 shareholders owning 3 percent of its common stock continuously for 3 years to nominate up to 20 percent of the board." It reasoned that "the ability of an unlimited

[1] See Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals Under Exchange Act Rule 14a-8, Release No. 34-95267 (July 13, 2022) (the "Proposing Release") at 8. By contrast, during the two previous proxy periods, the SEC staff received 90 and granted 45 such requests, and received 83 and granted 37 such requests, respectively. Id.

number of shareholders to aggregate their shareholdings to form a nominating group generally would be an essential element of the proposal."[2] In another example, the SEC explained that the staff may determine not to exclude as "substantially implemented" a shareholder proposal seeking a report from the board if the same report was issued by management, since having the report come from the board may be an essential element of the proposal.

II. Duplication Exclusion

Current Rule 14a-8(i)(11) provides for exclusion of a shareholder proposal from a company's proxy materials where 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. During the most recent proxy period, the SEC staff received 12 no-action requests based on this exclusion and granted three such requests.[3] Historically, the SEC has determined whether a proposal is substantially duplicative by considering whether the proposals share the same "principal thrust" or "principal focus." In the Proposing Release, the SEC cited concerns based on the staff's experience that varying interpretations of the current test may result in the under- or over-inclusion of shareholder proposals and may favor the proposal that is submitted first.

The proposed amendments therefore would specify that a proposal "substantially duplicates" another proposal if it addresses the same subject matter and seeks the same objective by the same means. To illustrate how the proposed test differs from the historical approach, the SEC stated that the staff no longer would consider the following proposals to be substantially duplicative: "(1) a proposal requesting that the company publish in newspapers a detailed statement of each of its direct or indirect political contributions or attempts to influence legislation; and (2) a proposal requesting a report to shareholders on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities."[4] It reasoned that although the principal thrust or focus of the proposals is the same, they seek different objectives by different means.

The SEC did acknowledge that the proposed amendments could create shareholder confusion and implementation challenges if shareholders were to approve multiple similar proposals and is seeking comments on this issue.

III. Resubmission Exclusion

Current Rule 14a-8(i)(12) provides for exclusion of a shareholder proposal from a company's proxy materials where the proposal deals with substantially the same subject matter as another proposal that previously has been included in the company's proxy materials within the preceding five calendar years if it was voted on at least once in the prior three years and failed to meet certain voting thresholds. During the most recent proxy period, the SEC staff received two no-action requests based on this exclusion and granted one such request.[5] Since the rule's adoption in 1983, the staff has interpreted this provision to exclude proposals that share the same "substantive concerns." As with the duplication exclusion, the SEC cited concerns in the Proposing Release that varying interpretations of the current test may result in the under- or over-inclusion of shareholder proposals. In particular, the SEC noted that

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[2] Proposing Release at 15.

[3] Id. at 8. By contrast, during the two previous proxy periods, the SEC staff received nine and granted four such requests, and received 16 and granted seven such requests, respectively. Id.

[4] Id. at 19.

[5] Id. at 8. By contrast, during the two previous proxy periods, the SEC staff received three and granted zero such requests, and received one and granted one such request, respectively. Id.

proposals addressing the same subject matter but calling for different actions may be over-excluded under the current test.

The proposed amendments therefore would provide that a proposal constitutes a resubmission if it "substantially duplicates" another proposal that was previously submitted for the same company's prior shareholder meetings. These amendments to Rule 14a-8(i)(12) thus would apply the same test specified under Rule 14a-8(i)(11), the duplication exclusion. To illustrate how the proposed test differs from the historical approach, the SEC stated that exclusion of the following proposals as resubmissions would not be warranted: "(1) a proposal requesting that the board adopt a policy prohibiting the vesting of equity-based awards for senior executives due to a voluntary resignation to enter government service (a 'government service golden parachute'); and (2) a proposal requesting that the board prepare a report to shareholders regarding the vesting of such government service golden parachutes that identifies eligible senior executives and the estimated dollar value of each senior executive's government service golden parachute."[6] It reasoned that although the proposals concern the same subject matter, they seek different objectives by different means.

Notably, the staff is seeking public comment on whether it would be appropriate to return to the previous standard of "substantially the same proposal." The SEC had abandoned this standard in 1983 due to concerns that shareholder proponents could evade exclusion merely by altering a few words from a previously submitted proposal.

IV. Conclusion

The SEC's proposal is not as far-reaching as some anticipated. It does not, for example, seek to amend the "ordinary business" basis for exclusion[7], or to revisit the amendments to the procedural requirements of Rule 14a-8 adopted in September 2020. The proposal does represent, however, the first substantive change to each of the relevant standards in roughly 40 years.

Two commissioners did not support the proposed amendments. Commissioner Mark T. Uyeda expressed dismay at the proposal's timing, noting that the impact of the 2020 amendments to the shareholder proposal rules has yet to be discerned, and he observed that the proposal lacks analysis of whether it would enhance value to investors. Commissioner Hester M. Peirce also criticized the proposal's timing and argued that the proposed amendments only create new ambiguities and subjectivity. Commissioner Peirce also expressed concern that thoughtful comments would be impossible given the short comment period and the fact that several other proposed rules also are pending comment.

The public comment period will remain open for 30 days following publication of the Proposing Release in the *Federal Register* or September 12, 2022, whichever period is longer.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Helene R. Banks (partner) at 212.701.3439 or hbanks@cahill.com; Geoffrey E. Liebmann (partner) at 212.701.3313 or gliebmann@cahill.com; Kimberly C. Petillo-Décossard (partner) at 212.701.3265 or kpetillo-decossard@cahill.com; or Sarah Klein-Cloud (attorney) at 212.701.3231 or sklein-cloud@cahill.com; or email publications@cahill.com.

[6] Id. at 28.

[7] The Proposing Release does, however, note: "[W]hile we do not propose to amend Rule 14a-8(i)(7), the ordinary business exclusion, at this time, we reaffirm the standards the Commission articulated in 1998 for determining whether a proposal relates to ordinary business for purposes of Rule 14a-8(i)(7)." Id. at 7. The relevant standards may be found in the 1998 Adopting Release.