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Shareholder Proposals May Rise After SEC Proxy Changes

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On July 13, the U.S. Securities and Exchange Commission proposed amendments to Rule 14a-8 under the Securities Exchange Act.[1]

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:

1. The substantial implementation exclusion;
2. The duplication exclusion; and
3. The resubmission exclusion.

While the SEC believes the proposal would facilitate the exercise of shareholders' rights by providing a clearer framework for application of the rule, the proposal largely fails to reduce the subjective nature of the analysis and, if adopted as proposed, is likely to significantly narrow companies' ability to exclude shareholder proposals.

Substantial Implementation Exclusion

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.

The SEC has historically applied various interpretive frameworks to determine whether a proposal has been substantially implemented.

The proposed amendments would replace the historical approach with a new test, under which a proposal may be excluded if the company already has implemented all the essential elements of the proposal. Far from removing subjectivity from the rule, the proposed rule still would require a fact-intensive analysis of which elements are essential and whether each such element has been addressed.

Moreover, the SEC's statement 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[2] indicates that shareholders would have significant control over the outcome of the analysis, likely leading to more disputes regarding inclusion being resolved in favor of the shareholder proponent.

The SEC's examples of how the test would be applied similarly suggest an approach that is likely to result in more shareholder proposals being included in companies' proxy materials.

For instance, the SEC stated in the proposing release 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.[3]

The SEC reasoned 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."[4] By contrast, under the current framework, proposals containing such minor variations generally have been unable to pass the substantial implementation analysis.

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.[5]

These examples suggest that, rather than reducing subjectivity, the proposed changes may very well introduce a level of ambiguity in what constitutes an essential element that likely would be resolved in favor of the shareholder proponent.

In its proposing release, the SEC provided statistics on the number of no-action requests received and processed during the last three proxy seasons under each of the relevant bases for exclusion.

The total requests under the substantial implementation exclusion rose to 110 for the most recent proxy season — from 90 and 83 in the prior two years — while the percentage of requests granted under this provision dropped to 33%, from 50% and 45% in the prior two years.[6]

If adopted as proposed, the proposed amendments seem likely to continue this trend.

Duplication Exclusion

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.

Historically, the SEC has determined whether a proposal is substantially duplicative by considering whether the proposals share the same principal thrust or principal focus.

The proposed amendments 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."[7] This new test reduces the fact-intensive nature of the current analysis, but replaces it with a standard that shareholder proponents easily could manipulate by slightly revising any one of the elements.

The impact of this new test, which the SEC itself acknowledged,[8] would be that a company may be required to include multiple, overlapping and even conflicting shareholder proposals that deal with the same subject matter in its proxy materials.

Historically, the duplication exclusion has not been the basis for many no-action requests; indeed, only 12 such requests were submitted this past proxy season.[9] However, the percentage of requests granted under this provision dropped sharply this past proxy season to 25% — from 44% in each of the prior two years.[10]

If adopted as proposed, the amendments seem likely to reverse this trend, and we anticipate shareholder proponents submitting, and the SEC granting, more requests on this basis.

Resubmission Exclusion

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.

Since the rule's adoption in 1983, the staff has interpreted this provision to exclude proposals that share the same substantive concerns.

The proposed amendments 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) would then apply the same test specified under Rule 14a-8(i)(11), the duplication exclusion, thus leaving open the same potential for manipulation as noted above.

Historically, the resubmission exclusion has been used only rarely.[11] If the amendments are adopted as proposed, we anticipate shareholder proponents would seize upon this opportunity to get around resubmission limits and submit significantly more such requests, as the proposed amendments appear to increase the likelihood of successful inclusion.

Conclusion

The number of shareholder proposals actually going to a shareholder vote has been on the rise since 2020.[12]

If the amendments discussed above are adopted as proposed, the overall numbers of both shareholder proposals submitted for inclusion in companies' proxy materials and those ultimately included in such materials likely will increase.

Moreover, the narrowing of the bases for exclusion as proposed likely will lead to a proliferation of proposals addressing the same subject matter with only minor variations year after year.

Accordingly, companies will need to reevaluate their strategies for engaging with shareholders making such proposals.

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

[2] Proposing Release at 14.

[3] Id. at 15.

[4] Id.

[5] Id. at 16.

[6] Id. at 8.

[7] Id. at 9.

[8] Id. at 20. ("[W]e are aware of the possibility that the proposed amendment could result in the inclusion in a company's proxy materials of multiple shareholder proposals dealing with the same or similar issue. This outcome could cause shareholder confusion and may lead to conflicting or inconsistent results and implementation challenges for companies if shareholders approve multiple similar, although not duplicative, proposals.").

[9] Id. at 8.

[10] Id.

[11] Id.

[12] PwC, Boardroom recap: The 2022 proxy season (Aug. 2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-boardroom-recap-2022-proxy-season.pdf at 2.