Governance & Securities Alert

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# SEC Adopts Amendments to Rule 14a-8:

## *More Stringent Requirements for Shareholder Proposals Will First Apply to 2022 Proxy Season*

*By Cathy Dixon and Andrew Holt*

On September 23, 2020, the Securities and Exchange Commission ("SEC" or "Commission") voted, 3 to 2, to adopt amendments to Rule 14a-8 under Section 14(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). Often referred to as the shareholder-proposal rule, Rule 14a-8 requires a company subject to the federal proxy rules to include shareholder proposals in its proxy statement and the accompanying proxy card, subject to certain procedural and substantive limitations. These amendments will impose more stringent requirements on the initial stock ownership eligibility threshold, which has not substantively changed since 1998, as well as the resubmission thresholds originally set in 1954.[1] Together, the SEC explained, these changes "are intended to modernize and enhance the efficiency and integrity of the shareholder proposal process for the benefit of all shareholders, including to help ensure that a shareholder proponent has demonstrated a meaningful 'economic stake or investment interest' in a company before the shareholder may draw on company resources to require the inclusion of a proposal in the company's proxy statement, and before the shareholder may use the company's proxy statement to command the attention of other shareholders to consider and vote on the proposal." However, the two dissenting Commissioners strongly disagreed, reflecting a sharp philosophical divide within the SEC.

The latest Rule 14a-8 amendments will not affect the upcoming 2021 proxy season. But for the 2022 season, as we explain in more detail below, they will make the following significant changes to the shareholder-proposal process:

- Replace the current stock ownership threshold for a proponent's initial submission -- which requires holding at least $2,000 or 1% worth of a company's eligible securities for at least one year through the date of the upcoming shareholder meeting -- with a three-tier stock ownership threshold that ties a longer minimum holding period to a smaller amount of stock (in market value), and eliminates the 1% alternative;
- Bar the proponent's aggregation of a small stock holding with those of other small shareholders (either directly or indirectly via a shareholder representative) to meet the initial eligibility threshold. Co-filing of shareholder proposals is still permitted, but only if each proponent is eligible;
- Clarify that a proponent may not submit more than one proposal to a company for the same shareholder meeting, either directly or indirectly through the use of a representative;
- Require a proponent to state that the proponent is able to engage with the company, in person or by teleconference, within a brief specified period after the initial submission; and

- Raise the resubmission thresholds for "repeat" proposals submitted and voted on multiple times during the past 5 calendar years, from 3% (first vote), 6% (second vote within the preceding 3 calendar years) and 10% (third/more vote within 3 calendar years of the last vote), to 5%, 15% and 25%, respectively. Aggregation of smaller holdings will not be permitted.

The final amendments to Rule 14a-8 will become effective 60 days after publication in the Federal Register, which has not yet occurred. Once effective, amended Rule 14a-8 will apply to any proposal submitted for inclusion in a company proxy statement to be filed in connection with an annual or special meeting held on or after January 1, 2022. Another special transition period will enable a shareholder who has continuously held at least $2,000 of a company's securities entitled to vote on the proposal for at least one year – running from the effective date of the amendments through the date he, she or it submits a proposal – to submit a proposal for an annual or special meeting to be held prior to January 1, 2023. A proponent invoking this one-time transition relief aimed at small holders is subject to an aggregation bar and must provide a statement, at the time of initial submission, indicating an intention to continue to hold the minimum amount through the date of the corresponding meeting.

In this Alert, we briefly summarize the amendments and outline the philosophical divisions reflected in the majority and dissenting statements of the Chair and his fellow Commissioners, which were largely mirrored in the public comment letters. Whether this division has consequences for the ultimate fate of the amendments could depend on the outcome of the fast-approaching Presidential and Congressional elections (among other variables outside the SEC's control).[2] We close with some observations on what promises to be a continuing philosophical divide, and offer a few practical suggestions for companies now considering what the amendments might mean for them and their shareholders as soon as next year.

## A. New Tiered Thresholds for Initial Submissions

Rule 14a-8(b) establishes the eligibility standards a shareholder proponent must satisfy to avoid omission of a proposal from the company's proxy materials. To be eligible to submit a proposal under the current rule, a shareholder proponent must have continuously held at least $2,000 in market value, or 1%, of a company's securities entitled to vote on that proposal for at least one year by the date the proposal is submitted. That minimum amount must continue to be held through the date of the meeting.

The following chart illustrates how the changes to Rule 14a-8(b) will operate in the initial submission context once the amendments become effective, subject to the one-time transition period for small shareholders who qualify under the current rule:

| Existing 14a-8(b) Requirements | Amended Requirements |
|---|---|
| Shareholder must have continuously held at least $2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year and provide a statement of intent to hold such securities through the date of the relevant meeting. | Shareholder must continuously hold the following amounts in market value of company securities entitled to be voted on the proposal for the minimum corresponding time period, and provide a statement that these amounts will be held continuously through the date of the relevant meeting*:<br>• $2,000 for 3 years;<br>• $15,000 for 2 years; or<br>• $25,000 for 1 year. |

*As noted above, the amendments provide for a one-time transition period enabling a shareholder to submit a proposal if, as of the effective date of the amendments, the proponent satisfies the current $2,000 threshold/one-year minimum holding period requirements and states an intention to continue to own the stock through the date of an annual or special meeting scheduled to be held on or after January 1, 2022 but prior to January 1, 2023.

The SEC believes that the proposed multi-tiered approach takes into account the varying situations of shareholders and will be preferable to the present one-size-fits-all framework of Rule 14a-8. The SEC has eliminated the 1% ownership alternative because it historically has not been utilized. The vast majority of investors that submit shareholder proposals do not reach that threshold, and those that do have means other than Rule 14a-8 to communicate their concerns to members of the board of directors and/or senior management.

The SEC has also eliminated the ability of shareholders to aggregate their securities holdings with those of other shareholders (whether directly or through representatives) to meet the heightened minimum stock ownership thresholds. In the SEC's view, such aggregation undermines the longstanding policy goal of ensuring that any shareholder who wants to use a company's proxy statement to advance a proposal has a sufficient economic stake or investment interest in the company to warrant commanding the attention and resources of the company and other shareholders.

### B. Submission of Shareholder Proposals by Representatives

It has been common practice for some individual shareholders to use a representative to assist in submitting a proposal. Under guidance set forth in Staff Legal Bulletin No. 14I ("SLB 14I", available here), the SEC staff expects a representative to submit the proposal to the company on the shareholder's behalf, along with certain documentation that provides evidence of the shareholder's ownership of the minimum amount of stock for the requisite period and the shareholder's written authorization for the representative to submit the proposal on the shareholder's behalf.

During the past few years, concerns have arisen with respect to the misuse of representatives that the SEC believes have not been addressed adequately by SLB 14I. For this reason, the SEC has amended the eligibility requirements of Rule 14a-8(b) to require those shareholder proponents who use a representative to provide at the time of initial submission certain documentation attesting that the shareholder in fact does support the proposal and authorizes the representative to act on his, her or its behalf.

Specifically, the amended rule requires documentation that:

- Identifies the company to which the proposal is directed;
- Identifies the annual or special meeting for which the proposal is submitted;
- Identifies the shareholder submitting the proposal and the shareholder's designated representative;
- Includes the shareholder's statement authorizing the designated representative to submit the proposal and otherwise act on the shareholder's behalf;
- Identifies the specific proposal to be submitted;
- Includes the shareholder's statement supporting the proposal; and
- Is signed and dated by the shareholder.

In response to critical comments, the SEC made clear in the relevant text of amended Rule 14a-8 that "where a shareholder proponent is an entity, and thus can act only through an agent, compliance with the amendment will not be necessary if the agent's authority to act is apparent and self-evident such that a reasonable person would understand that the agent has authority to act." The adopting release provides examples of how this will work in the case of individuals submitting a proposal on behalf of a corporation (the CEO), a state or local trust fund (an elected or appointed official designated as custodian) and a limited investment partnership (the general partner).

## C. Shareholder Engagement

The SEC acknowledges that shareholder proposals may constitute the sole method of engagement with companies for small individual shareholders. By the same token, the SEC believes that the Rule 14a-8 process has been used unnecessarily by shareholders (or even non-shareholders, as we explain below) with a "soapbox" cause to burden a company and other shareholders with a proxy vote that could have been avoided had a meaningful dialogue between the company and the proponent occurred at or around the time of initial submission.

Against the background of these competing concerns, the SEC amended Rule 14a-8(b) to add a shareholder engagement component to the numerical eligibility criteria. Shareholder proponents will be obligated to engage with the company with respect to their proposal to avoid exclusion. There is no reciprocal obligation on the part of the company – the company is not required to engage.

More specifically, the amendment requires:

- A statement from each proponent that he, she or it is able to meet with the company in person or via teleconference no less than 10 and no more than 30 calendar days after submission of the shareholder proposal; and
- The inclusion of contact information, as well as business days and specific times during the company's regular business hours when the proponent would be available to discuss the proposal with the company. If a proponent has co-filers and would like to designate one of them as its representative for engagement purposes, the single "lead filer" must be identified and agreed upon by each co-filer.

## D. Rule 14a-8(c): One-Proposal Limit

Rule 14a-8(c) currently provides that "*each shareholder* may submit no more than one proposal to a company for a particular shareholders' meeting." The SEC is concerned that this language is susceptible to abuse by some opportunistic shareholders and/or representatives, which the agency believes undermines the policy foundation of the one-proposal limit.

Accordingly, the SEC amended the one-proposal provision to replace the words "*each shareholder*" with "*each person*." Under the amended rule, a proponent may only submit one proposal in his, her or its own name and may not simultaneously serve as representative to submit a different proposal on behalf of another shareholder for consideration at the same meeting. Likewise, a representative will not be allowed to submit more than one proposal to be considered at the same meeting, notwithstanding the fact that the representative would be submitting each proposal on behalf of different shareholders.

## E. Resubmission Thresholds

Since 1954, shareholder proposals have been excludable by the company in the year submitted if they deal with substantially the same subject matter as another proposal (or proposals) previously included in the company's proxy materials and voted on within the past five calendar years, and received less than the following percentages of the votes cast: 3% (first vote), 6% (second vote within three years of the first vote), or 10% (third vote (or more) within three years of the last vote). The SEC expressed the concern in the adopting release that the existing resubmission thresholds now fail to distinguish between proposals that are more likely to obtain majority support upon resubmission from those that are not. From the SEC's perspective, these thresholds no longer serve their essential purpose – to relieve companies and their shareholders of the burden of analyzing proposals that had been voted on and rejected by a substantial number of shareholders in previous years, and are therefore unlikely to gain a majority of the votes cast in the relatively near future.

To solve this problem, the SEC amended Rule 14a-8(i)(12) to replace the current resubmission thresholds with new thresholds of 5%, 15%, and 25 % of votes cast within a five-year period. The chart below illustrates the differences between the current and amended resubmission thresholds:

| Existing 14a-8(i)(12) Requirements | Amended Requirements |
|---|---|
| If the proposal deals with substantially the same subject matter as another proposal (or proposals) that has been previously included in the company's proxy materials and voted on within the preceding five calendar years, if the most recent vote occurred within the preceding three calendar years and that vote was:<br>• Less than 3% of the votes cast if proposed and voted on once;<br>• Less than 6% of the votes cast on its last submission to shareholders if proposed and voted on twice; or<br>• Less than 10% of the votes cast on its last submission to shareholders if proposed and voted on three or more times. | A shareholder proposal may be excluded from a company's proxy materials if it deals with substantially the same subject matter as a proposal (or proposals) previously included in that company's proxy materials and voted on within the preceding five calendar years, if the most recent vote occurred within the preceding three calendar years and that vote was:<br>• Less than 5% of votes cast if previously proposed and voted on once;<br>• Less than 15% of the votes cast if previously proposed and voted on twice; or<br>• Less than 25% of the votes cast if previously proposed and voted on three or more times. |

### *Failed Momentum Requirement Proposal*

Based on critical comments received, the SEC declined to adopt the proposed Momentum Requirement. This proposal would have allowed companies to exclude proposals that had been submitted three or more times in the preceding five years, but would not otherwise be excludable under the 25% threshold, if: (i) that proposal had received less than a majority of votes cast when most recently voted on; and (ii) support had declined by 10% or more (also measured in terms of the percentage of votes cast) compared to the results of the immediately preceding shareholder vote on a proposal involving substantially the same subject matter.

Commenters who objected to the proposed Momentum Requirement argued that its application could lead to anomalous results. For example, a proposal that garnered higher overall support (e.g., 44% of votes cast) compared to another proposal could be excluded if it experienced a decline in support of 10% or more of the votes cast, whereas a proposal receiving less support (e.g., 27% of votes cast) that did not experience a 10% or more decline in support would not be excludable. The SEC made clear, however, that it would be open to reconsidering a Momentum Requirement after it had an opportunity to fully evaluate the results of application and implementation of the amended resubmission thresholds.

## F. Observations on the Philosophical Divide and a Few Practical Tips for Public Companies

SEC Chair Clayton, an Independent, and Republican Commissioners Elad L. Roisman and Hester Peirce agreed that the Rule 14a-8 amendments will, as the Chair put it in a statement delivered during the September 23 open meeting, "better ensure that the interests of those who submit, and re-submit, shareholder proposals are appropriately aligned with the interests of their fellow shareholders who must take the time to review, consider and vote on those proposals." Commissioner Roisman observed in his own statement that the amendments "strike a better balance by ensuring that a shareholder who submits a proposal to a public company has interests that are more likely to be aligned with the other shareholders who bear the expense." And Commissioner Pierce voted with the majority to approve the amendments, although her personal view is that the amendments did not go far enough to address serious flaws in the shareholder-proposal mechanism. If given the opportunity, as she explained in a separate statement, she would rescind Rule 14a-8 in its entirety.

The dissents of Democratic Commissioners Allison Herren Lee and Caroline Crenshaw, in contrast, reflect a shared concern that the amendments will have the effect of foreclosing participation in the proxy process by small shareholders. Commissioner Crenshaw noted, in her dissenting statement, that the amendments "put[] the great majority of investors to a harsh choice: maintain a diversified and well-balanced portfolio as experts recommend, but be shut out from corporate discourse, or participate in the conversation but take on the greater risk that investing $25,000 of retirement savings in a single stock will pay off." In her view, "the implication … is that the wealthy are more likely to possess ideas worthy of corporate consideration." Commissioner Lee pointed out, in her dissenting statement, that the amendments are the "capstone in a series of [SEC] policies that will dial back shareholder oversight of management at the companies they own." She focused in particular on the prospect that the amendments could operate to stifle the evolving public debate on "climate change, workforce diversity, independent board leadership, and corporate political spending, as well as other ESG-related issues."

There are early signs that these strong philosophical differences, which were echoed in the public comment letters, persist. The concerns outlined by those commenters who still opposed the proposed amendments in the aftermath of the SEC vote can perhaps best be distilled in the following public statement of the Executive Director of the Council of Institutional Investors: "The amendments weaken the voice of investors and jeopardize the fairness of U.S. public capital markets by making the filing process more complicated, constricting and costly."

On the other hand, many in the corporate community agree with the SEC majority that the combined effect of the amendments will be to reduce costs and other burdens borne largely by public companies and their shareholders. In the words of a senior U.S. Chamber of Commerce official: "If you are going to issue a shareholder proposal, you should own a substantial amount of shares for a period of time, which shows the dedication that investor has to the company. This ensures that the investor is not just coming in with a small stake to make some sort of rhetorical point."[3]

Despite the extended transition period for compliance, voting results during the 2021 proxy season may have implications for some companies when the extended transition period for compliance comes to an end for meetings held on or after January 1, 2022. For example, application of the heightened resubmission thresholds for annual or special meetings of companies with calendar fiscal year ends will require a look-back at the 2021 voting results in the event a calendar-year company decides to request no-action relief from the staff of the Division of Corporation Finance on the eve of the 2022 proxy season under amended Rule 14a-8(i)(12). Moreover, calendar-year companies will soon begin receiving shareholder proposal submissions in accordance with the Rule 14a-8 prescribed timeline, while large institutional investors will be announcing their 2021 voting policy priorities in the near future. Both can be leading indicators of shareholder sentiment that may influence proxy voting decisions in 2021. Recent media reports raise the possibility that large influential institutional shareholders may be persuaded to throw their considerable voting support behind shareholder proposals on ESG matters, and even join activist "just vote no" campaigns targeting individual directors standing for re-election next year.[4]

We recognize that not all public companies receive shareholder proposals, and therefore may not be affected by the recent amendments. For those that do, however, it is vitally important to understand what the amendments mean to the company itself as well as to its shareholders and members of such other key constituencies as employees and customers, many of whom may be sympathetic to the positions advocated by activist shareholder proponents. Accordingly, we recommend that corporate boards be fully briefed on what key shareholders and analysts – including the influential proxy advisory firms – think are the strengths and weaknesses in the company's risk profile, because significant areas of risk can attract shareholder proposals and/or influence institutional shareholder voting determinations. Remember also that the SEC's Division of Corporation Finance looks for a statement of the fully informed views and judgments of directors when evaluating no-action requests asserting as grounds for exclusion Rule 14a-8(i)(7)("ordinary business) and/or (i)(5)("relevance").

## ENDNOTES

[1] For more detail on the relevant regulatory history, see Note 2 to the adopting release.

[2] Because the 2020 Rule 14a-8 amendments were designated as a "major rule" within the meaning of the Congressional Review Act (*see id.* at Note 264), a repeal by Congress in the next term is a possibility. How viable that possibility is may be determined by a number of factors outside the SEC's control, including but not necessarily limited to the outcome of the upcoming Presidential and Congressional elections.

[3] Lindsay Frost, *New SEC Rule May Spark Director Reelection 'No' Votes*, AGENDA WEEK, Oct. 5, 2020.

[4] *See, e.g., id.*

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