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SEC Proposes Amendments to Shareholder Proposal Rule

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On July 13, 2022, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") held an Open Meeting at which the Commissioners voted to propose for public comment amendments to Rule 14a-8 ("Rule 14a-8") under the Securities Exchange Act of 1934, as amended, which governs the process for including shareholder proposals in a company's proxy statement (the "Proposed Amendments"). Rule 14a-8 generally requires companies to include shareholder proposals in their proxy statements, subject to several substantive and procedural bases for exclusion. The Proposed Amendments revise three of the substantive bases for exclusion of shareholder proposals:

- Rule 14a-8(i)(10) (the "substantial implementation exclusion"),
- Rule 14a-8(i)(11) (the "duplication exclusion") and
- Rule 14a-8(i)(12) (the "resubmission exclusion").

The Proposed Amendments were approved by the Commission by a 3-2 vote. Comments on the Proposed Amendments may be submitted until the later of September 12, 2022 and 30 days from publication in the Federal Register. As we have discussed previously, the staff in the SEC's Division of Corporation Finance under the leadership of Director Renee Jones has been favorable to shareholder proposals reaching the ballot, and the Proposed Amendments reflect similar policy judgments. If adopted as proposed in the release (the "Proposing Release"), the narrower grounds for exclusion will likely result in more shareholder proposals appearing on companies' ballots in future proxy seasons.

PROPOSED AMENDMENTS

Substantial Implementation Exclusion

The substantial implementation exclusion currently allows a company to exclude a shareholder proposal if the company has "already substantially implemented" the proposal, and the Proposed Amendments would define "substantially implemented" to mean the company has "already implemented the essential elements of the proposal".

Historically, the SEC staff has applied various frameworks to determine whether a proposal has been "substantially implemented", including whether the company's policies, practices and procedures compare favorably with the guidelines of the proposal, whether a proposal's underlying concerns and essential objectives have been met and whether each of a proposal's elements have been implemented. The Proposed Amendments would revise the "substantially implemented" analysis to require a determination of which elements of the proposal are "essential elements" and then a determination of whether those elements have been addressed. In determining the essential elements, the degree of specificity of the proposal and its stated primary objectives would guide this analysis. If the Proposed Amendments are adopted as proposed, a shareholder proposal could only be excluded under Rule 14a-8(i)(10) if the

company has implemented all of its essential elements. Conversely, if a proposal has not been implemented precisely as required in the shareholder proposal but the differences between the proposal and the company's actions are not essential to the proposal, then the company would still be able to exclude the proposal.

It is clear the SEC intends the Proposed Amendments to narrow the substantial implementation exclusion. For example, the Proposing Release expressly identifies that a proxy access bylaw proposal that contemplates no cap on the number of shareholders that can be aggregated to meet the minimum level of ownership (plus a cap of 25% of the board that can be elected via proxy access) could not be excluded by a company that has previously adopted a proxy access bylaw with a cap of 20 shareholders that can be aggregated and a cap of 20% of the board. Although such proposals have historically been excluded on substantial implementation grounds, the SEC would now view the unlimited number of shareholders able to form a nominating group as an "essential element" of the proposal and that would mean the proposal could not be excluded.

Duplication Exclusion

The duplication exclusion currently allows a company to exclude a shareholder proposal if 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 Staff has considered whether shareholder proposals have the same "principal thrust" or "principal focus" to determine whether a proposal "substantially duplicates" another previous proposal. The Proposed Amendments would revise the principal thrust/principal focus analysis to require a determination of whether the proposal "addresses the **same subject matter** and seeks the **same objective** by the **same means**" (emphasis added).

In addition, because the duplication exclusion only permits exclusion of the later-received proposal, it currently is advantageous to be the first shareholder to submit a proposal. The Proposed Amendments seek to allow the consideration by a company's shareholders of later-received proposals that may be similar to and/or address the same subject matter as an earlier-received proposal that seeks different objectives or offers different means of addressing the same matter.

Resubmission Exclusion

The resubmission exclusion currently allows a company to exclude a shareholder proposal if the proposal "addresses substantially the same subject matter as a proposal, or proposals, previously included in the company's proxy materials within the preceding five calendar years" if the matter was voted on at least once in the last three years and did not receive sufficient shareholder support[1]. The Proposed Amendments again narrow the circumstances under which the exclusion would be available, providing that a proposal constitutes a resubmission if it "substantially duplicates" a prior proposal, which would have the same meaning as the Proposed Amendments provide for the duplication exclusion (*i.e.*, if it "addresses the same subject matter and seeks the same objective by the same means").

Ordinary Business Exclusion

Additionally, while not proposing any new rules or amendments, the Proposing Release reaffirms the standards that the Commission articulated in 1998 for determining whether a proposal relates to "ordinary business" in connection with Rule 14a-8(i)(7) (the "ordinary business exclusion"). In the Proposing Release, the SEC underscores that proposals focusing on "significant policy issues" would not be excludable and notes that calls for specific methods, time frames or detail do not necessarily amount to micromanagement. This is clearly intended to signal Commission support for Staff Legal Bulletin 14L from November 2021 and its narrower interpretation of the ordinary business exclusion.

ANALYSIS

In the Proposing Release, the Commission states that the Proposed Amendments are intended to provide greater certainty and transparency to shareholders and companies as they evaluate whether these bases for exclusion would apply to particular proposals and thereby facilitate communication between shareholders and the companies they own, as well as among a company's shareholders. While the Proposed Amendments may clarify the duplication exclusion and

the resubmission exclusion, such clarity comes at the expense of the efficacy of these grounds for exclusion, as the "same subject matter, same objective, same means" test will be a difficult challenge for companies to surmount in seeking an exclusion on these grounds. Whether changes to the substantial implementation exclusion will increase certainty and transparency is less obvious, as the "essential element" test may require several proxy seasons for companies to gauge how the SEC staff intends to apply this standard. Indeed, Commissioner Hester Peirce, who voted against the Proposed Amendments, questioned whether the Proposed Amendments would ultimately provide the desired certainty and transparency, arguing they "introduce new terms for our staff to interpret and market participants to debate".[2]

Regardless of whether the standards provide more certainty, the practical effect of the Proposed Amendments seems inevitable. If the Proposed Amendments are adopted as proposed, we expect to see an increased number of shareholder proposals in general and an increased number of shareholder proposals making the ballot at companies' annual meetings. This is likely to be particularly true for ESG-related shareholder proposals, as proponents may be able to carefully word otherwise similar proposals to emphasize interrelated but ultimately different concepts to avoid the substantial implementation exclusion. For example, otherwise similar environmentally-focused proposals may be able to prioritize calls for Scope 3 emissions reporting, absolute net zero emissions reductions and the adoption of science-based targets as three distinct essential elements, and the SEC has clearly indicated that the proponents' own stated primary objectives will be determinative of the proposal's essential elements. Particularly when combined with the ordinary business exclusion that has been narrowed by the SEC staff (as now endorsed by the Commission), companies may need to contend with a large number of increasingly detailed ESG proposals with fewer tools to exclude the proposals from the ballot and potentially more challenging negotiations with proponents when trying to agree to a withdrawal of proposals on acceptable terms.

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[1] Rule 14a-8(i)(12)'s resubmission thresholds are: 5% of the votes cast if previously voted on once, 15% of the votes cast if previously voted on twice and 25% of the votes cast if previously voted on three or more times. These resubmission thresholds were reviewed and amended by the Commission on September 23, 2020.

[2] Commissioner Peirce, "Exclusion Preclusion: Statement on the Shareholder Proposals Proposal" (July 13, 2022).