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SEC PROPOSES TO AMEND KEY ELEMENTS OF CERTAIN RULE 14A-8 BASES FOR EXCLUSION OF SHAREHOLDER PROPOSALS

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On July 13, 2022, by a 3-2 party-line vote, the SEC proposed amendments to Rule 14a-8 to modify three of the existing bases for the exclusion of shareholder proposals from a company's proxy statement, namely:

- The substantial implementation exclusion;
- The duplication exclusion; and
- The resubmission exclusion.

The SEC believes the amendments may provide greater certainty and transparency to shareholders and companies as they evaluate whether a particular proposal may be excluded. By contrast, the dissenting Commissioners, Peirce and Uyeda, objected to these proposed amendments before evaluating the effects of 2020 amendments to Rule 14a-8 that only recently became effective. Further, Commissioner Uyeda expressed concern that the amendments may discourage company efforts to exclude proposals and further discourage interest in becoming public companies.

The deadline for comments on the SEC proposals is 30 days after publication in the Federal Register or September 12, 2022, whichever is later.

Substantial Implementation Exclusion

The substantial implementation exclusion set forth in Rule 14a-8(i)(10) allows a company to exclude a shareholder proposal that "the company has already substantially implemented." Given the factual nature of whether a company has already substantially implemented the subject of a proposal, the SEC believes the existing rule may be difficult to apply in a consistent manner, and is insufficiently focused on the specific actions requested by a proposal.

The SEC proposes to modify the substantial implementation exclusion to permit exclusion "[i]f the company has already implemented the essential elements of the proposal" [emphasis added]. The SEC believes that the focus on the specific elements of a proposal would provide a reliable

indication of whether the actions taken to implement a proposal are sufficiently responsive to the shareholder proposal to determine if the principal elements of the proposal have been substantially implemented. The SEC acknowledged that determining whether a proposal could be excluded would still require substantive analysis in determining which elements of the proposal are the "essential elements" and an analysis of whether those elements have been met.

The SEC provided an example of the proposed revised substantial implementation exclusion, explaining that it historically would support the exclusion of a proposal seeking the adoption of a proxy access provision that would allow an unlimited number of shareholders who collectively have owned 3% of the company's outstanding common stock for 3 years to nominate up to 25% 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% of its common stock continuously for 3 years to nominate up to 20% of the board. The SEC advised that under the proposed amendment, such an exclusion would not be appropriate because under the revised rule, the ability of an *unlimited* number of shareholders to aggregate their shares to form a nominating group would be considered an essential element of the new proposal.

The SEC expects that the determination of the essential elements of a proposal would be guided by an analysis of the degree of specificity of the proposal and its stated primary objectives. The dissenting Commissioners expressed skepticism as to whether the rule amendments would enhance predictability, with Peirce commenting on the example above: "[a]nother observer could easily conclude that these details are not at the heart of those proposals. Subjectivity lives on."

Duplication Exclusion

The exclusion set forth in Rule 14a-8(i)(11) allows a company to exclude a proposal if it substantially duplicates one submitted by another proponent that will be included in the company's proxy materials for the same meeting. In evaluating whether proposals are substantially duplicative, the staff has historically considered whether the proposals share the same "principal thrust" or "principal focus," which the SEC indicated may necessitate fact-intensive, case-by-case judgments that can be difficult to apply in a consistent and predictable manner. The SEC noted that the current rule permits exclusion only of the later-received proposal, which operates to the advantage of the first shareholder submitting a proposal that is substantially duplicated, and the proposal accepted would prevent consideration of the later received proposal, even if the later one may have received greater shareholder support.

The SEC proposes to amend Rule 14a-8(i)(11) to provide that a proposal will substantially duplicate another proposal if it "addresses the same subject matter and seeks the same objective by the same means." The SEC believes the proposed amendment would provide a clearer standard for exclusion and that a second proposal would not necessarily be pre-empted if it addresses the same subject matter, but seeks implementation by different means.

As an example, the SEC identified the following two hypothetical proposals: (1) one 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) the other requesting a report to shareholders on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities. In contrast to current practice, under which the staff had previously concurred that the proposals were substantially duplicative, the SEC indicated that under the amended rule the proposals would not be deemed substantially duplicative because, although they both address the subject matter of the company's political and lobbying expenditures, they seek different objectives by different means.

Commissioner Peirce expressed concern that "[c]larity in this case seems to mean defanging the exclusion. Unless proposals are seeking exactly the same things, it seems that neither will be excludable as duplicative. The likely result — one the Proposing Release acknowledges — is multiple potentially overlapping or even conflicting proposals on the same topic on the same proxy."

Resubmission Exclusion

The resubmission exclusion set forth in Rule 14a-8(i)(12) provides that a shareholder proposal or proposals that address substantially the same subject matter as another proposal or proposals that have previously been included in a company's proxy materials within the preceding five calendar years may be excluded from its proxy materials for any meeting held within three calendar years of the last time it was included if the proposal received (i) less than 5% of the vote if proposed once within the preceding five calendar years, (ii) less than 15% of the vote if proposed twice within the preceding five calendar years, or (iii) less than 25% of the vote if proposed three times or more within the preceding five calendar years. In considering whether proposals may be excluded, the staff has historically focused on whether proposals shared the same "substantive concerns," which necessitates a fact-intensive, case-by-case judgment that the SEC believes may either be interpreted too broadly or narrowly.

The SEC proposes to amend Rule 14a-8(i)(12) to permit exclusion of a proposal that "substantially duplicates" a prior proposal, with "substantially duplicates" a prior proposal meaning that it "addresses the same subject matter and seeks the same objective by the same means" – instead of limiting the analysis to substantially the same subject matter. The five and three year calendar periods, and the requisite voting thresholds, are not proposed to be changed.

The SEC believes this modified approach may provide a more accurate indication of whether shareholders have already provided their views on a particular issue and the proposed means to address it. Additionally, while the approach still involves some fact-intensive judgment, the SEC believes that the proposed standard is clearer and promotes more consistent and predictable determinations. By contrast, Commissioner Peirce believes "[t]he proposed replacement test . . . will be used to shield shareholder proponents from the consequences of their failed votes. As with the

duplication exclusion basis, the resubmission basis will not exclude any proposal unless it is nearly identical to a prior proposal.

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We believe that these proposals, if adopted, could make it more difficult for companies to obtain no-action relief from the SEC to exclude shareholder proposals under these three bases of Rule 14a-8, and conversely, may encourage shareholders to make additional proposals in company proxy statements, even if there is overlap with prior company action related to the proposal, or duplication of prior proposals.

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