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SEC Update

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SEC tightens procedural requirements and resubmission thresholds for shareholder proposals

The SEC recently adopted amendments to Rule 14a-8 under the Securities Exchange Act of 1934 to tighten the requirements that govern the initial submission and resubmission of shareholder proposals for inclusion in a company's proxy materials. These and associated amendments represent some of the most significant changes to the rule's eligibility provisions in over 20 years. The SEC's goal in approving more stringent requirements is to ensure that shareholder-proponents have a demonstrated "economic stake or investment interest" in a company before imposing the costs of the shareholder proposal process on the company and its other shareholders. The rule changes were adopted over the dissenting votes of two Commissioners.

The most notable amendment modifies the current US$2,000 ownership threshold to require continuous ownership of the company's securities at that level for at least three years, and adds two higher, alternative ownership thresholds with shorter minimum holding periods. The SEC also has increased the levels of shareholder support a proposal must receive to be eligible for resubmission to the same company in future years. Among the other amendments, the SEC has expanded the reach of the existing "one-proposal rule" to provide that a single person may not submit multiple proposals at the same shareholder meeting, whether as a shareholder or as a representative of a shareholder.

The amendments will become effective on January 4, 2021, but will first apply to any proposal submitted for an annual or special shareholder meeting to be held on or after January 1, 2022. The SEC has extended limited transitional relief to shareholder-proponents relying on a US$2,000 ownership position to submit a proposal.

The SEC's adopting release describing the amendments (No. 34-89964) can be viewed here.

Amendments to ownership requirements

Ownership thresholds

The current minimum ownership requirement to submit a proposal under Rule 14a-8 was last amended in 1998. The amendments modify the existing ownership requirement and add two alternative ownership thresholds.

Rule 14a-8(b)(1) currently requires a shareholder that wishes to have a proposal included in a company's proxy materials to have continuously held at least US$2,000 in market value, or one percent, of a company's securities entitled to vote on the proposal for at least one year as of the date on which the shareholder submits the proposal. In addition, the shareholder must continue to hold the securities through the date of the shareholder meeting for which the proposal is submitted.

Alternative ownership thresholds. The amended rule replaces the one-year minimum holding period with a three-year holding period, eliminates the one percent-ownership test, and adds two alternative ownership thresholds with different holding periods. Under Rule 14a-8(b)(1)(i), a shareholder will be eligible to submit a proposal if the shareholder has continuously held at least:

- US$2,000 of the company's securities entitled to vote on the proposal for at least three years;
- US$15,000 of the company's securities entitled to vote on the proposal for at least two years; or
- US$25,000 of the company's securities entitled to vote on the proposal for at least one year.

The shareholder may satisfy any one of the three thresholds to be eligible to submit a proposal. The tiered approach reflects the SEC's determination that, to ensure a shareholder has a sufficient

investment interest in the company, "it is appropriate to place greater emphasis on the length of continuous stock ownership when the economic stake is less and vice versa."

Transitional relief. The SEC recognizes that the increased holding period will result in a delay in submissions by shareholders with a US$2,000 ownership position if they do not yet meet the three-year holding period requirement. Limited transitional relief will permit shareholders that are eligible to submit a proposal as of the amendment effective date based on the US$2,000 ownership test to maintain their eligibility if they continue to hold their securities.

Under Rule 14a-8(b)(3), a shareholder that has continuously held at least US$2,000 of a company's securities entitled to vote on the proposal for at least one year as of January 4, 2021 (the effective date of the amendments), and continuously maintains ownership of at least US$2,000 of such securities from January 4, 2021 through the date on which the shareholder submits the proposal, will be eligible to submit the proposal – and need not comply with the revised ownership thresholds – for an annual or special meeting to be held before January 1, 2023. The shareholder will be required to provide the company with a written statement that the shareholder intends to continue holding at least US$2,000 of the securities through the date of the shareholder meeting at which the proposal will be considered.

Calculation of market value. Whether a proponent holds the minimum required value of securities is based on the market value of the securities, determined as of any date within 60 calendar days before the date on which the shareholder submits the proposal. As under the current rule, the shareholder should determine the market value of the securities by multiplying the number of securities continuously held for the relevant eligibility period by the highest selling price during the 60-day measurement period. The SEC cautions that a security's highest *selling* price is not necessarily the same as its highest *closing* price. The SEC clarifies that a shareholder relying on the transitional relief summarized above should look at whether the shareholder's securities are valued at US$2,000 or more on any date within 60 days before January 4, 2021.

Aggregation

The amendments eliminate the current right of multiple shareholders to aggregate their individual security holdings in the company to satisfy the ownership requirement.

Aggregation. Since it first adopted ownership thresholds in 1983, the SEC has permitted shareholders to aggregate their security holdings with the holdings of other shareholders to meet the US$2,000 ownership threshold. Aggregation under the current rule enables multiple shareholders collectively to satisfy the ownership test even if none or only some of the shareholders individually can meet the US$2,000 threshold.

Rule 14a-8(b)(1)(vi) prohibits a shareholder-proponent from aggregating its security holdings with those of another shareholder or group of shareholders to satisfy any of the three ownership thresholds. Instead, each shareholder-proponent individually must meet one of the three thresholds to be eligible to submit or co-file a proposal. The SEC expresses the view that continuing to permit aggregation would undermine the goal of ensuring that each shareholder-proponent has a sufficient economic stake or investment interest in the company.

Shareholders whose shares are held in joint tenancy may submit proposals individually or jointly. The one-proposal limit described below collectively applies to all persons having an interest in the same shares.

Co-filers. The SEC confirms that shareholder-proponents will continue to be permitted to co-file proposals as a group if each shareholder-proponent in the group meets the eligibility requirement. The SEC decided not to amend Rule 14a-8 to require shareholder-proponents co-filing proposals to designate a lead filer. The agency pointed out, however, that as a matter of best practice, in their initial submission letter, co-filers should:

- "clearly state" that they are co-filing the proposal with other proponents;
- identify the lead filer; and
- indicate whether the lead filer is authorized to negotiate with the company and withdraw the proposal on behalf of the other co-filers.

The SEC reminds co-filers of a proposal that a failure to identify the nature of their coordination as co-filers could render individually submitted, later-received proposals susceptible to exclusion under Rule 14a-8(i)(11) on the

basis that those proposals substantially duplicate the first proposal submitted by a co-filer.

Documentation for use of representatives

Under a new eligibility requirement, a shareholder-proponent that uses a representative to submit a proposal will be required to provide specified documentation to the company. The new requirement incorporates some information of the type shareholders currently deliver in accordance with SEC staff guidance.

Role of representatives. The SEC notes that some shareholders use lawyers, investment advisers, and other representatives to prepare and submit proposals for administrative convenience or to benefit from the representative's greater experience with the shareholder proposal process. After submitting the proposal, the representative often speaks and acts on the shareholder's behalf. The SEC added the new procedural requirement primarily to address its concern that in some cases the proposal may be primarily of interest to the representative, rather than to the shareholder-proponent.

New documentation requirement. Under Rule 14a-8(b)(1)(iv), a shareholder that uses a representative to submit a proposal must provide the company with 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 topic of the proposal to be submitted;
- includes the shareholder's statement supporting the proposal; and
- is signed and dated by the shareholder.

In a departure from the proposed amendments, the shareholder will be required only to identify the specific proposal topic and not to provide a copy of the text of the proposal.

Exclusion from documentation requirement. Under Rule 14a-8(b)(1)(v), where the shareholder-proponent is a corporation, partnership, or other entity, and therefore can act only through an officer, general partner, or other representative, the shareholder is not required to comply with the new documentation requirement "so long as the representative's authority to act on the shareholder's behalf is apparent and self-evident such that a reasonable person would understand that the agent has the authority to submit the proposal and otherwise act on the shareholder's behalf." The apparent-authority test would exclude compliance with the documentation requirement by entities in the following circumstances identified by the SEC in the adopting release:

- where a corporation's CEO submits a proposal on behalf of the corporation;
- where an elected or appointed official who is a custodian of state or local trust funds submits a proposal on behalf of one or more of the funds;
- where a partnership's general partner submits a proposal on behalf of the partnership; or
- where an adviser to an investment company submits a proposal on behalf of the investment company.

By contrast, the SEC says that compliance would be required if an adviser in a private relationship with a client submits a proposal on the client's behalf in accordance with their private contractual arrangement, since it would not be apparent and self-evident that the scope of the adviser's representation extends to the submission of proposals.

Engagement with the shareholder-proponent

The SEC also has added to the rule's eligibility requirements what the SEC refers to as a "shareholder engagement component." Under current market practice, companies frequently discuss proposals with shareholder-proponents to explore ways of addressing concerns reflected in the proposals short of including them in the proxy materials. The new requirement is intended to encourage these discussions by requiring the shareholder to advise the company of the shareholder's availability for this purpose.

Statement by shareholder-proponent. Under Rule 14a-8(b)(1)(iii), the shareholder-proponent is required to accompany the proposal with a statement that the shareholder-proponent is able to meet with

the company in person or via teleconference no less than 10 calendar days nor more than 30 calendar days after the proposal submission date. The SEC expects that in some cases discussions soon after a proposal is submitted will promote resolution of the matter and avoid a contested disposition of the proposal through the no-action process. Where shareholder-proponents co-file a proposal, all co-filers must either (1) agree to the same dates and times of availability or (2) identify a single lead filer that will provide dates and times of the lead filer's availability to engage with the company on behalf of all co-filers.

The statement must include the shareholder's contact information and identify business days on which, and specific times at which, the shareholder is available to discuss the proposal with the company. The available times must be during the regular business hours of the company's principal executive offices. If the company's proxy statement for the prior year's annual meeting does not identify the regular business hours of the company's principal executive offices, the statement should specify the shareholder's availability at times between 9:00 a.m. and 5:30 p.m. on business days in the time zone of the company's principal executive offices.

The SEC emphasizes that "companies will not be required to engage with a shareholder-proponent or to state that they attempted to engage with the shareholder-proponent prior to submitting a no-action request." The SEC believes that the prospect of addressing a shareholder's concerns without including the shareholder's proposal in the proxy materials will provide a company with an incentive to pursue engagement.

Compliance guidelines. In its release, the SEC provides additional detail on the operation of the new requirement:

- the contact information and availability must be that of the shareholder-proponent and not of any representative, although a representative may participate with the shareholder-proponent in the discussions with the company;
- because the rule requires identification of the "business days" and "times" at which the shareholder-proponent will be available, the statement must specify more than one date and more than one time;
- although the proxy rules do not require a company to identify in its annual proxy statement the regular business hours of its principal executive offices, the SEC "suggests" that, if the company chooses to do so, it present the information alongside disclosure of the proposal submission deadline for the next annual meeting;
- the company and the shareholder may hold discussions on a mutually acceptable date that does not fall within the 10- to 30-day period identified in the statement, including when the company is not available to participate on the dates and times identified by the shareholder-proponent; and
- if the shareholder-proponent's availability changes, the shareholder-proponent should notify the company and provide an alternative date or dates and an alternative time or times for the engagement.

Amendment of one-proposal rule

The one-proposal limit in Rule 14a-8(c) restricts the submission by a single shareholder-proponent of multiple proposals for a particular shareholder meeting. The SEC has amended the restriction to apply it to "each person" rather than, as under the current rule, "each shareholder." The amendment is intended to prevent shareholder-proponents and representatives from circumventing the one-proposal limit by submitting proposals on behalf of other shareholders.

Amended Rule 14-8(c) states that:

- "each person" may submit no more than one proposal, directly or indirectly, to a company for a particular shareholder meeting; and
- a person may not rely on the securities holdings of another person for the purpose of meeting the eligibility requirements and submitting multiple proposals for a particular shareholder meeting.

The SEC indicates that the term "person" encompasses entities and all persons under their control, including employees. Consistent with the prior scope of the restriction as applied to shareholders, all persons that have an interest in the same security, such as the record and beneficial owners and joint tenants, are considered to be one person.

The amendment extends the one-proposal limit to investment advisers and other representatives who submit proposals on behalf of shareholders they represent. The proposed application of the restriction

to representatives attracted substantial interest during the comment process. The SEC explains that, under the amended rule:

- a shareholder-proponent may not submit one proposal under his or her name and simultaneously serve as a representative of another shareholder to submit a different proposal on the other shareholder's behalf for consideration at the same meeting; and
- a representative may not submit more than one proposal for consideration at the same meeting, even if the representative were to submit each proposal on behalf of different shareholders.

The SEC notes that under the control test applied to define the term "person," if an investment adviser at an advisory firm submits a proposal to a company on behalf of a shareholder-proponent, neither that adviser nor any other adviser at the advisory firm would be permitted to submit a proposal to the company on behalf of a different shareholder-proponent for the same meeting. The amendment, however, will not prohibit a single representative from representing multiple co-filers in connection with the submission of a single proposal.

The SEC states that the amendment is not intended to narrow the array of services performed by representatives in advising shareholder-proponents. To the extent that such services involve the submission of a proposal, however, representatives will be subject to the one-proposal limit and will be precluded from submitting another proposal to the same company for the same shareholder meeting.

Amendment of resubmission thresholds

The SEC amended Rule 14a-8(i)(12) to increase the levels of shareholder support a proposal must receive before the proponent may submit a proposal addressing "substantially the same subject matter" for consideration at a future shareholder meeting of the same company. If a proposal fails to receive the required level of support, the shareholder-proponent must wait until the expiration of a cooling-off period before resubmitting the proposal.

The SEC says that it believes the current resubmission thresholds, which were adopted in 1954, "do not adequately distinguish between proposals that have a realistic prospect of obtaining a broader or majority support in the near term and those that do not." By increasing the thresholds, the SEC seeks to relieve companies and shareholders of having "to continually expend resources and consider proposals with a minimal likelihood of success."

Increased resubmission thresholds. Under the amended rule, a shareholder proposal will be excludable from a company's proxy materials if it 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 most recent vote occurred within the preceding three calendar years and the most recent vote was:

- less than 5 percent of the votes cast if previously voted on once;
- less than 15 percent of the votes cast if previously voted on twice; or
- less than 25 percent of the votes cast if previously voted on three or more times.

The SEC determined that the more significant increases in the second and third thresholds are warranted by the fact that shareholders already will have considered a proposal two or three times before its resubmission becomes subject to those thresholds. The new resubmission thresholds of 5, 15, and 25 percent replace the current thresholds of 3, 6, and 10 percent, respectively. Under the current rule, a proposal obtaining at least 10 percent of the votes cast could be resubmitted without restriction.

The SEC estimates that, of the proposals resubmitted between 2011 and 2018, 85 percent would have been eligible for resubmission under the new thresholds.

No momentum requirement. The SEC decided not to add a proposed "momentum requirement" to the resubmission criteria. Such a requirement would have permitted companies to exclude resubmitted proposals that previously had been voted on three or more times within the preceding five years and met the resubmission thresholds, but had received declining levels of shareholder support. After considering comments on the proposal, the SEC agreed that it would be "anomalous" to permit exclusion of proposals that, even with a decline in support, would have earned more shareholder votes than some includable proposals able to pass muster under the momentum standard.

Looking ahead

The shareholder proposal process has been one of the most contested aspects of federal proxy regulation since the adoption of Rule 14a-8. Some companies believe that the rule provides shareholders with excessively liberal access to their proxy materials, while various shareholders feel that the rule places too many restrictions on that access. The latest amendments shift the focus of debate from the substantive grounds on which a company may exclude a shareholder proposal from its proxy materials to the requirements a shareholder-proponent must meet to establish eligibility to submit a proposal.

In its release the SEC has emphasized the importance of the rule changes in reducing costs to companies of the shareholder proposal process and in addressing the risk that shareholder-proponents may use the process in a way that does not benefit a company or its other shareholders. The release also highlights the increasing number of ways outside of the shareholder proposal process in which shareholders may seek to engage companies on matters of interest. The statements of the two dissenting Commissioners reflect the main themes expressed by shareholder groups and others in comments on the rule proposal. In particular, many of those who opposed the amendments believe that the SEC has unduly reduced the ability of shareholders, particularly smaller investors, to oversee and engage with management through the shareholder proposal process.

Whatever the ultimate impact of the amendments, it will be important for companies, shareholders, and representatives and their advisers to become acquainted with the intricacies of the amended rule before the new provisions begin to apply in connection with the 2022 proxy season.

This SEC Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed on the following page of this update.

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