

November 11, 2019

SEC Proposes Amendments to Regulate Proxy Voting Advice and Modernize the Shareholder Proposal Rule

Reform of proxy advisory firms and the shareholder proposal process has been on the business community's agenda for some time. On November 5, 2019, the SEC proposed amendments to regulate proxy voting advice (the "Proxy Release")¹ and amendments to modernize the process for shareholder proposals under Exchange Act Rule 14a-8 (the "Shareholder Proposal Release").² The SEC issued the releases in separate 3-2 votes, with Chairman Clayton and Republican Commissioners Peirce and Roisman forming the majority in both instances and Democratic Commissioners Jackson and Lee dissenting. This Alert summarizes key aspects of the two rule proposals.

Overview

Background. The rule proposals reflect the SEC's ongoing focus on reforming the proxy process. They follow the SEC's recent guidance clarifying the applicability of the federal proxy rules to proxy voting advice and the proxy voting responsibilities of investment advisers (as discussed in this prior [Alert](#)), roundtables on the proxy process in 2018 and proxy advisory services in 2013, and the publication of a concept release on the U.S. proxy system in 2010.

Regulation of Proxy Voting Advice. The Proxy Release contains proposed amendments to its rules that exempt reports issued by proxy advisory firms from the filing and information requirements of the federal proxy rules. If adopted, the proposed amendments would require enhanced disclosure of material conflicts of interest, provide for an opportunity for all companies and other soliciting persons to review proxy voting advice before it is sent to the proxy advisory firm's clients, and create a mechanism for investors to be informed about differing views on the advice. In addition, the proposed rule would amend the definition of "solicitation" in Rule 14a-1(l) to specifically cover proxy advisory firm reports, thereby codifying recent SEC guidance that proxy advisory firm recommendations are "solicitations" and are subject to the anti-fraud provision of the federal proxy rules.

Modernization of Shareholder Proposal Rule. The Shareholder Proposal Release contains proposed amendments to Rule 14a-8 that would, if adopted:

- update the initial ownership threshold for eligibility to include a proposal in a company proxy statement, including tiered ownership requirements that would provide three options that combine dollar amount of securities owned and length of time held;
- update the "one proposal" rule to clarify that a single person may not submit multiple proposals at the same shareholder's meeting, whether the person submits a proposal as a shareholder or as a shareholder representative; and
- modernize the current resubmission thresholds of 3%, 6% and 10% for matters voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively.

Chairman Clayton also signaled that the SEC's proxy reform efforts continue. In his public statement, Chairman Clayton stated that he expects that the Commission will next address "proxy plumbing" and the universal proxy card.

¹ *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice*, Release No. 34-87457 (Nov. 5, 2019) (available [here](#)).

² *Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8*, Release No. 34-87458 (Nov. 5, 2019) (available [here](#)).

Amendments to Regulate Proxy Voting Advice

Proposed Amendments to Rule 14a-2(b). The proposed amendments would amend Rule 14a-2(b), which provides proxy advisory firm reports with an exemption from the information and filing requirements of the proxy rules, to condition the exemption on:

- Enhanced disclosure of material conflicts of interest in their proxy voting advice;
- Giving companies (and certain other persons who are running solicitations) an opportunity to review and provide feedback on proxy voting advice before it is issued, with the length of the review period dependent on the number of days between the filing of the definitive proxy statement and the date of the shareholder meeting; and
- Including in the proxy voting advice, at the request of the company or another soliciting person, a hyperlink (or analogous electronic medium) directing the recipient of the advice to a written statement that sets forth the company's (or soliciting person's) views on the proxy voting advice.

Enhanced Conflicts Disclosure. The Proxy Release specifies that the enhanced conflicts of interest disclosures “should be sufficiently detailed so that clients of proxy voting advice businesses can understand the nature and scope of the interest, transaction, or relationship to appropriately assess the objectivity and reliability of the proxy voting advice they receive.” Boilerplate language that these conflicts “may” exist would not be sufficient.

Review and Feedback Period. Under the proposed amendments, for definitive proxy statements filed less than 45 but at least 25 days before the date of the shareholder meeting, the proxy advisory firm would be required to provide the company (or other soliciting person) no fewer than three business days to review the proxy voting advice and provide feedback. For definitive proxy statements filed 45 days or more before the shareholder meeting, the proxy advisory firm would be required to provide the company (or other soliciting person) at least five business days for review and feedback. The proxy advisory firm would have no obligation to provide the proxy voting advice to the company (or other soliciting person) for definitive filings made less than 25 days before the shareholder meeting. Finally, to rely on the exemptions, a proxy advisory firm would be required to provide a company (or other soliciting person) with a final, two-business day notice period prior to the delivery of the proxy voting advice to its clients. This final notice would allow a company and/or soliciting person to determine whether or not to provide a statement in response to the advice and request that a hyperlink to its response be included in the voting advice delivered to proxy advisory firms' clients (as discussed below).

Response to Proxy Voting Advice. Under the proposed rule, as a condition to the exemptions in Rule 14a-2(b), a proxy advisory firm would, upon request, be required to include in its proxy voting advice and in any electronic medium used to deliver the advice a hyperlink (or other analogous electronic medium) that leads to the company's (or other soliciting person's) statement about the proxy advisory firm's voting advice. To take advantage of this provision, companies (or other soliciting persons) would be required to provide the hyperlink to the proxy advisory firm no later than the expiration of the final, two-business day notice period. The Proxy Release contains a helpful chart that illustrates the timing of the review and feedback period and final notice of voting advice under the proposed rule. The company's (or other soliciting person's) statement would constitute a “solicitation” and would be subject to the proxy rules' filing requirements and the anti-fraud prohibitions.

Codification of SEC Guidance regarding “Solicitation.” The proposed rule would codify the SEC's interpretation that proxy voting advice generally constitutes a solicitation subject to the federal proxy rules by amending Rule 14a-1(l) to make clear that the terms “solicit” and “solicitation” include any proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder approval is solicited, and that is furnished by a person who markets its expertise as a provider of such advice, separately from other forms of

investment advice, and sells such advice for a fee. In addition, the proposed rule would codify the SEC’s view that any proxy voting advice furnished by a person who furnishes such advice only in response to an unprompted request would not constitute a solicitation.

Proposed Amendments to Rule 14a-9. Proxy voting advice exempt from filing under Rule 14a-2(b) exemptions is not exempt from Rule 14a-9, which prohibits materially misleading misstatements or omissions in proxy solicitations. The proposed amendments would add to the four examples in the note to Rule 14a-9 of what may be considered misleading within the meaning of the rule the following: “Failure to disclose material information regarding proxy voting advice . . . such as the proxy voting advice business’s methodology, sources of information, conflicts of interest or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.”

Proposed Amendments to Rule 14a-8

The following chart briefly summarizes the existing Rule 14a-8 requirements for initial submission and resubmission and how the proposed amendments to Rule 14a-8 in the Shareholder Proposal Release would affect them:

Requirement/Provision	Existing Rule 14a-8 Requirements	Proposed Amendments to Rule 14a-8 Requirements
<p>Ownership Thresholds (Rule 14a-8(b))</p>	<p>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.</p> <p>Two or more shareholders can aggregate their holdings to meet the threshold.</p>	<p>Shareholder would be required to have continuously held at least:</p> <ul style="list-style-type: none"> • \$2,000 in market value of the company’s securities entitled to vote on the proposal for at least 3 years; • \$15,000 in market value for at least 2 years; or • \$25,000 in market value for at least 1 year. <p>In addition, the current 1% ownership threshold – which is essentially irrelevant – would be eliminated.</p> <p>Two or more shareholders would not be allowed to aggregate their holdings to reach the threshold.</p>
<p>Resubmission Thresholds (Rule 14a-8(i)(12))</p>	<p>If the proposal deals with substantially the same subject matter as another proposal that has been previously included in the company’s proxy materials within the preceding 5 calendar years, a company may exclude the proposal from its proxy materials for any shareholder meeting held within 3</p>	<p>If the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company’s proxy materials within the preceding 5 calendar years, a company would be permitted to exclude the proposal from its proxy materials for any shareholder meeting if the most recent vote occurred within the</p>

Requirement/Provision	Existing Rule 14a-8 Requirements	Proposed Amendments to Rule 14a-8 Requirements
	<p>calendar years of the last submission if the proposal received:</p> <ul style="list-style-type: none"> • Less than 3% of the vote if proposed once within the preceding 5 years; • Less than 6% of the vote on its last submission to shareholders if proposed twice previously within the preceding 5 years; or • Less than 10% of the vote on its last submission to shareholders if proposed 3 times or more previously within the preceding 5 years. 	<p>preceding 3 years and the most recent vote was:</p> <ul style="list-style-type: none"> • Less than 5% of the votes cast if previously voted on once; • Less than 15% of the votes cast if previously voted on twice; or • Less than 25% of the votes cast if previously voted on 3 times or more. <p>In addition, Rule 14a-8(i)(12) would be amended to include a new “momentum requirement,” which would allow companies to exclude proposals dealing with substantially the same subject matter as proposals previously voted on by shareholders 3 or more times in the preceding 5 years that would not otherwise be excludable under the 25% threshold if:</p> <ul style="list-style-type: none"> • The most recent vote on the proposal received less than a majority of the votes cast; and • Support declined by 10% or more compared to the immediately preceding shareholder vote on the matter.

The Shareholder Proposal Release addresses so-called “proposal by proxy” where a proposal is brought by someone on behalf of a shareholder. It codifies and expands upon the Staff guidance provided in November 2017 in Staff Legal Bulletin No. 14I. A person seeking to act for a shareholder in submitting a proposal would be required to provide written 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-proponent and the designated representative;
- Includes the shareholder’s statement authorizing the designated representative to submit the proposal and/or 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.

To address a problem that companies face dealing with some proponents who are notoriously difficult to deal with and refuse to engage, the proposed amendments would require a proponent to provide a written statement that he or she is able to meet with the company in person or by telephone no less than ten nor more than 30 days after submitting the proposal. The proponent would be required to provide the company with contact information and specific times during which he or she would be available. Failure to provide this information would be grounds for procedural exclusion of the proposal.

The current rules provide that each shareholder may submit no more than one proposal to a company per meeting. The Shareholder Proposal Release proposes to amend that provision so that no "person" could submit more than one proposal per meeting. This change is designed to prohibit situations in which a person submits a proposal on his or her own behalf and a different proposal on behalf of another shareholder. In addition, the Shareholder Proposal Release requests comment on whether the rules should prohibit natural-person shareholders from using representatives to submit proposals.

The SEC believes that the proposed amendments appropriately balance shareholders' ability to submit proposals with the costs incurred by companies and their shareholders in addressing such proposals.

Comment Period

Commissioner Roisman acknowledged that crafting the proposals in the Proxy Release "involved much line-drawing along the way." As such, the Commission welcomes feedback and is encouraging interested parties to submit comments on any or all aspects of the proposed rule amendments in both Releases. The comment periods for both Releases will remain open for 60 days following their respective publication in the Federal Register, which means that interested parties will have until about mid-January 2020 to submit comments.

The Proxy Release, which responds to some valid concerns expressed by the issuer community about proxy advisory firms, represents nonetheless an assault on the very business model of those firms and they will surely be vigorous in their opposition. ISS, the largest of the proxy advisors, has already sued the Commission challenging its view that proxy advisory reports are solicitations. The Commission surely expects that any final rule is destined for the U.S. Court of Appeals for the D.C. Circuit, a venue that has not always been receptive to Commission rulemakings. Expect this rulemaking to be a difficult one.

The Shareholder Proposal Release, which is relatively modest compared to the Proxy Release, nevertheless elicited much vocal opposition from Commissioners Jackson and Lee at the SEC's Open Meeting. We should expect to hear from commenters how shareholder proposals have been the source of much salutary corporate governance reform over the past two decades, that small shareholders can have good ideas and that sometimes it takes time for good ideas to gestate. Still, the proposal represents the type of rule re-examination that the Commission should be doing and, while there will no doubt be disagreements, the proposed amendments represent a series of policy choices on which reasonable minds can disagree.

Update on Rule 14a-8 No-Action Requests

At the Practising Law Institute's 51st Annual Institute on Securities Regulation, Shelley Parratt, Deputy Director of the SEC's Division of Corporation Finance, provided additional information on the Division's recent announcement that it

would not necessarily respond to all Rule 14a-8 no-action requests, either in writing or at all (see our prior Alert [here](#)). As previously noted, the Staff's response to a request for no-action relief could be that the Staff concurs, disagrees or declines to state a view with respect to a company's asserted basis for exclusion. In addition, beginning in the 2019-20 proxy season, the Staff may respond orally to such a request, instead of in writing.

Ms. Parratt stated that all of the relevant correspondence and Staff responses would be published on the SEC's web site along with a chart showing the Staff's action. Thus, for each no-action request, the chart will indicate whether the Staff concurred, disagreed or declined to state a view. Where the Staff's response is communicated in written form, it will be posted on the SEC's web site in a manner similar to the Staff's current practice. Ms. Parratt expects the chart will be updated about one or two times a week and anticipates that the chart will be available on the SEC's web site later this month.

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If you have any questions about this Alert, please contact your usual legal advisor at Ropes & Gray.