July 25, 2022

SEC Proposes to Amend Rule 14a-8 Shareholder Proposal Provisions Regarding Substantial Implementation, Duplication and Resubmission

Rule 14a-8 under the Exchange Act requires issuers that are subject to the federal proxy rules to include shareholder proposals in their proxy statements to shareholders, subject to certain procedural and substantive requirements.

On July 13, 2022, the SEC issued a release (the "Release") containing proposed amendments to, and seeking public comment on, three of Rule 14a-8's substantive bases for an issuer to exclude a shareholder proposal:

- 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 Release characterizes the proposed amendments (the "Proposed Amendments") as an "update [to] certain substantive bases for exclusion" that are "intended to improve the shareholder proposal process based on modern developments and the staff's observations." The Release states that, if adopted, the Proposed Amendments "would set forth a clearer framework for the application of certain of the rule's substantive bases for the exclusion" and "thereby provide greater certainty and transparency to shareholders and companies as they evaluate whether these bases would apply to particular proposals."

The Proposed Amendments are discussed in detail below. The Appendix to this Alert contains a marked version of the relevant portions of Rule 14a-8(i) to show the changes that would be effected by the Proposed Amendments.

A. Rule 14a-8(i)(10) – The Substantial Implementation Exclusion

At present, Rule 14a-8(i)(10) allows an issuer to exclude a shareholder proposal that "the company has already substantially implemented." The Release states:

- The SEC believes that it is "appropriate under Rule 14a-8(i)(10) to apply a 'substantial' implementation standard, rather than the 'full' implementation standard."
- In view of the staff's experience with the substantial implementation exclusion, the SEC is concerned that (i) the current rule may be difficult to apply in a consistent and predictable manner and (ii) the "language of the current rule is insufficiently focused on the specific actions requested by a proposal – *i.e.*, its elements – and, thus, it may not serve the original purpose of the exclusion to avoid the consideration of proposals on which a company already has 'favorably acted.'"

In light of these considerations, the Proposed Amendments would amend Rule 14a-8(i)(10) to provide that a shareholder proposal may be excluded as substantially implemented "[i]f the company has already implemented the essential elements of the proposal." The SEC believes that an analysis focused 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 proposal such that it has been substantially implemented." The SEC made these additional observations:

- To identify essential elements of a shareholder proposal, the "degree of specificity of the proposal and of its stated primary objectives would guide the analysis." Thus, as amended, a shareholder proposal could be excluded as substantially implemented "only if the company has implemented all of its essential elements."

- A shareholder proposal would not have to be rendered entirely moot or be fully implemented in exactly the manner the proposal desires, in order to be excluded. An issuer would be permitted to exclude a proposal "it has not implemented precisely as requested if the differences between the proposal and the company's actions are not essential to the proposal."

- If a shareholder proposal contains more than one element, every element of the proposal need not be implemented, but each essential element would need to be implemented to exclude the proposal. If a shareholder proposal contains only one essential element, that single essential element would need to be implemented to exclude the proposal.

B. Rule 14a-8(i)(11) – The Duplication Exclusion

At present, Rule 14a-8(i)(11), the duplication exclusion, permits an issuer 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." The Release notes:

- Historically, when evaluating whether proposals are substantially duplicative, the SEC staff has considered whether the proposals share the same "principal thrust" or "principal focus." In the no-action letter process, the SEC staff's experience has shown that this analytical framework can be difficult to apply in a consistent and predictable manner because, as with the "substantial implementation" standard under current Rule 14a-8(i)(10), there are numerous potential approaches to evaluating whether a proposal is "substantially" duplicative and to identify a proposal's principal thrust or focus.

- In addition, Rule 14a-8(i)(11) permits an issuer to exclude only later-received shareholder proposals, which works to the advantage of the first shareholder to submit a proposal that is substantially duplicative of a later-submitted shareholder proposals for the same meeting. This creates an incentive to submit a proposal quickly, thereby permitting the first shareholder proposal to preempt consideration of later-received proposals at the meeting, notwithstanding the fact that a later proposal (if it were voted on) might have received greater shareholder support.

In view of these issues with the existing duplication exclusion, the Proposed Amendments would amend Rule 14a-8(i)(11) to provide that a proposal "substantially duplicates" another proposal if it "addresses the same subject matter and seeks the same objective by the same means."

- As an example, the Release posits two proposals (i) a proposal 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 (ii) a proposal requesting a report to shareholders on the company's process for identifying and prioritizing legislative and regulatory public policy advocacy activities. In the past, the SEC staff had concurred with an issuer that these two proposals were substantially duplicative when analyzing the principal thrust or focus of the proposals.[1] As amended, the two 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.

- The SEC believes that amended Rule 14a-8(i)(11) provides a clearer standard for exclusion that would assist the staff in more efficiently reviewing and responding to no-action requests. The amendment would provide greater certainty and transparency regarding the standards applied under the rule, thereby assisting shareholder proponents (in drafting their proposals) and issuers (in determining whether a proposal may be excludable under the rule).

- In addition, amended Rule 14a-8(i)(11) would reduce incentives for proponents to submit a proposal quickly, reduce incentives for proponents to attempt to preempt other proposals those proponents do not agree with, and lead to the consideration, at the same shareholder meeting, of multiple shareholder proposals that present different means to address a particular issue.

C. Rule 14a-8(i)(12) – The Resubmission Exclusion

At present, Rule 14a-8(i)(12), the resubmission exclusion, permits an issuer to exclude a shareholder proposal from its proxy materials 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 received support below specified vote thresholds on the most recent vote. Regarding the background of this provision, the Release notes:

- In 1983, the SEC revised the standard for exclusion of a proposal under this provision from "substantially the same proposal" to "substantially the same subject matter." In the adopting release for this revision,[2] the SEC, responding to commenters, stated that while "interpretation of the new provision will continue to involve difficult subjective judgments . . . those judgments will be based upon a consideration of the substantive concerns raised by a proposal rather than the specific language or actions proposed to deal with those concerns" such that "an improperly broad interpretation of the . . . rule will be avoided." (Emphasis added).

- The SEC increased the minimum vote thresholds necessary for resubmission under the provision in 2020 (the "2020 Amendments").[3] In the proposing release for the 2020 Amendments,4 the SEC requested comment on whether it should change the Rule 14a-8(i)(12) standard or its application. One commenter suggested that a revised standard focusing not on the "substantive concerns" of similar proposals but, instead, focusing on the "'specific language or actions proposed to deal with those concerns" would be useful to "allow different approaches to the same or a similar issue to be voiced and provided as options for shareholders to support." However, the SEC did not adopt any of the suggestions to the applicable standard in response to its request for comments.

The Release explains that the SEC is now concerned that the existing "substantially the same subject matter" standard under Rule 14a-8(i)(12) may not accomplish its stated purpose because focusing on whether proposals share the same "substantive concerns" rather than "the specific language or actions proposed to deal with those concerns" may not, as the SEC initially believed, avoid an "improperly broad interpretation" of the rule. The Release states:

- The SEC shares "the concerns previously expressed by commentators that the 'substantially the same subject matter' standard unduly constrains shareholder suffrage because of its potential 'umbrella' effect – *i.e.*, that it could be used to exclude proposals that have only a vague relation, or are not sufficiently similar, to earlier proposals that failed to receive the necessary shareholder support."

- The current standard may discourage experimentation with new ideas because "it limits proponents' ability to modify their proposals to address a similar subject matter in subsequent years to build broader shareholder support," while restricting other shareholders from submitting different or newer approaches to address the same issue.

To address these concerns, the Proposed Amendments would revise the standard of what constitutes a resubmission under Rule 14a-8(i)(12) from a proposal that "addresses substantially the same subject matter" as a prior proposal to a proposal that "substantially duplicates" a prior proposal. This is the same standard that applies under current Rule 14a-8(i)(11) (the duplication exclusion).[5] The Proposed Amendments also would provide that, for purposes of Rule 14a-8(i)(12), a proposal "substantially duplicates" another proposal if it "addresses the same subject matter and seeks the same objective by the same means." The SEC made the following observations about the proposed change to Rule 14a-8(i)(12):

- To be excludable under the resubmission exclusion, a proposal must not only address the same subject matter as a prior proposal but also must seek the same objective by the same means. Stated differently, the standard for exclusion would focus on the specific objectives and means sought by a proposal with respect to a given subject matter. The SEC expects this approach to provide a more accurate indication of whether shareholders have already provided their views on a particular issue and the proposed means to address it.

- The potential umbrella effect of the resubmission exclusion would be alleviated by enabling proponents to make adjustments to their proposals to build broader support and also allow other proponents to put forth their own proposals with different ways to address the same issue.

Consequently, the Release states, the proposed changes to Rule 14a-8(i)(12) would be more consistent with the purpose of the exclusion, which is to avoid the continued consideration of "proposals that have generated little interest when previously presented to the security holders," by recognizing that "proposals that address the same subject matter, or share the same substantive concerns, do not necessarily garner equivalent levels of shareholder interest and support." In addition, the Release states that the proposed changes to Rule 14a-8(i)(12) would:

- Provide a clearer standard for exclusion, assist the staff in reviewing and responding to no-action requests and benefit shareholders and issuers by facilitating more consistent and predictable determinations regarding the exclusion of proposals.

- Provide greater certainty and transparency regarding the standards to be applied under the rule, thereby aiding shareholder-proponents in drafting their proposals, and issuers in determining whether a proposal may be excludable under the rule.

D. Potential Ramifications

If adopted as proposed, by narrowing the bases for exclusion, the Proposed Amendments will result in a "Cambrian explosion" of shareholder proposals. There will be significantly more proposals, submitted and on the ballot. There also will be more variation among proposals in the same general subject area, as proponents seek to craft proposals that will survive an exclusion challenge. In particular, environmental and social proposals – such as those addressing climate change and human rights – are likely to increase significantly. Furthermore, by narrowing the resubmission exclusion, many subjects will perpetually become part of the annual meeting ritual, irrespective of their level of shareholder support. These dynamics will result in new engagement strategies and challenges, for both issuers and shareholders.

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If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney contacts.

1. The Release cites Pfizer Inc., SEC No-Action Letter (pub. avail. Feb. 17, 2012).
2. Rel. No. 34-20091 (Aug. 16, 1983).
3. Rel. No. 34-89964 (Sept. 23, 2020). Prior to the 2020 Amendments, Rule 14a-8(i)(12) required a proposal to receive at least: (i) 3% of the vote if previously voted on once; (ii) 6% of the vote if previously voted on twice; or (iii) 10% of the vote if previously voted on three or more times. The 2020 Amendments increased the levels of support a shareholder proposal must receive to be eligible for resubmission at the same company's future shareholders' meetings from 3, 6 and 10 percent to 5, 15 and 25 percent, respectively. The Release notes that the SEC continues to assess the impact of the 2020 Amendments.
4. Rel. No. 34-87458 (Nov. 5, 2019).
5. The Release notes that the Proposed Amendments would promote more consistent outcomes when comparing a given proposal against proposals submitted for the same shareholder meeting, for purposes of Rule 14a-8(i)(11), and against proposals considered at prior meetings, for purposes of Rule 14a-8(i)(12), in consideration of the similar objectives of these exclusions.