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Shareholder Proposals under Rule 14a-8: Practical Guidance for Proxy Season

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Introduction

Rule 14a-8 of the Securities Exchange Act of 1934 provides a framework allowing a public company shareholder to request that a proposal be included in the company's proxy statement, to be voted upon at a company's shareholder meeting. While Rule 14a-8 provides a means for shareholders to propose changes to a company's governance practices, it can also be a source of controversy, particularly when proposals deviate from the preferences of the board of directors or other shareholders. This risk has become more significant as the number of shareholder proposals submitted to a vote has increased in recent years, in part as a result of a heightened focus by shareholders on ESG-related matters, as well as changes in the Securities and Exchange Commission's ("SEC") rules and practices governing the ability of companies to exclude shareholder proposals under certain circumstances.

As the 2023 proxy season nears, public companies should take stock of the current environment relating to shareholder proposals under Rule 14a-8 so as to effectively respond in the event one or more are submitted.

Background

A company subject to Section 14A of the Exchange Act must include a shareholder proposal in its proxy statement for a shareholder meeting if the proposal complies with the procedural and eligibility requirements of Rule 14a-8, unless the company excludes the proposal on one of 13 substantive bases.[1] Once included in a company's proxy

[1] Rule 14a-8 is distinct from advance notice bylaw provisions, which typically allow shareholders to propose director nominees or business at a shareholder meeting (although outside of the company's proxy statement). Rule 14a-8 is also distinct from Rule 14a-19 under the Exchange Act, which allows shareholder proposed director nominees to be included on a company's proxy card, subject to certain requirements. Refer to the Debevoise & Plimpton Update dated December 14, 2022 (accessible here).

statement, the shareholder proposal may be voted on by shareholders at the next annual meeting or special meeting on a non-binding and advisory basis.

Rule 14a-8 contains a number of procedural requirements[2] relating to the shareholder proposal and accompanying materials, as well as eligibility requirements applicable to the proponent shareholder.[3] Among other requirements, a shareholder proposal must be submitted at least 120 days before the anniversary of the company's proxy statement for the prior year, and no more than one proposal may be submitted by a shareholder for a single shareholder meeting. A shareholder proposal that satisfies the procedural and eligibility requirements of Rule 14a-8 may nonetheless be excluded by a company if the substance of the proposal relates to certain matters enumerated by Rule 14a-8(i).[4] A company that wishes to exclude such a proposal will typically seek informal relief from the staff of the SEC's Division of Corporation Finance that it will not recommend enforcement action against the company for excluding the shareholder proposal from its proxy statement. This "no-action request" must be submitted to the SEC and the proponent shareholder simultaneously at least 80 days before the company files its definitive proxy statement. The SEC staff will then typically respond to the request by providing informal relief, denying relief, or denying relief subject to the proponent shareholder submitting a revised proposal within seven days.

Evolving Standards on Substantive Exclusion

The substantive bases on which a shareholder proposal submitted under Rule 14a-8 may be excluded from a proxy statement have recently been narrowed in application, with further limitations on certain exclusions recently proposed. This has led, and is expected to continue to lead, to more Rule 14a-8 shareholder proposals required to be included in companies' proxy statements. In November 2021, the SEC staff published Staff Legal Bulletin 14L ("SLB 14L"), which rescinded three prior staff legal bulletins,[5] and, with them, settled approaches to the application of two of the more commonly relied upon bases of substantive exclusion: the "ordinary business" and "economic relevance"

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2 The proponent shareholder must submit written statements to the company that the shareholder intends to hold the requisite amount of securities through the date of the shareholder meeting and that the shareholder is able to meet with the company between 10 to 30 days after submission of the proposal.

3 Rule 14a-8 specifies holding period (ranging between one and three years) and market value (ranging between $2,000 and $25,000) thresholds, and requires that the shareholder proposal is limited to 500 words.

4 The 13 substantive grounds for exclusion are: improper under state law; violation of law; violation of proxy rules; personal grievance/special interest; economic relevance; absence of power/authority; ordinary business; director elections; conflict with company's proposal; substantial implementation; duplication; resubmissions; and specific amount of dividends.

5 Staff Legal Bulletin 14I, Staff Legal Bulletin 14J and Staff Legal Bulletin 14K.

grounds for exclusion.[6] Similarly, the SEC staff's responses to company requests for no-action relief in 2022 overall reflected a more restrictive application of the "substantial implementation" and "duplication" grounds for exclusion, at times conflicting with no-action relief provided previously. Further, in July 2022, the SEC proposed amendments to Rule 14a-8 that would further limit the ability of a company to exclude shareholder proposals on the grounds of "substantial implementation," "duplication," and "resubmission."

Ordinary Business

The ordinary business ground for exclusion permits a company to exclude a shareholder proposal that relates to "a matter relating to the company's ordinary business operations." The rationale is that the subject matter of a proposal should not infringe on matters that are "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight" and should not have the effect of "micromanaging" a company on matters where shareholders would not be in a position to make informed decisions. Note, however, that this ground for exclusion does not apply to a proposal that focuses on social policy issues that are sufficiently significant so as to transcend ordinary business.

A common example of the ordinary business ground for exclusion involves a proposal relating to employee matters such as workforce turnover, employee safety, or the written content of employee training materials. The SEC staff has generally concurred that such matters relate to, and do not transcend, ordinary business matters.

In SLB 14L, however, the SEC staff took a more expansive view of "significant social policy," noting that exclusion is not appropriate if the proposal raises issues of broad societal impact that transcend the ordinary business of the company. SLB 14L also narrowed the "micromanagement" element of the ground for exclusion by stating that proposals "seeking detail or seeking to promote timeframes or methods do not *per se* constitute micromanagement." SLB 14L referred specifically to relief granted in prior years for the exclusion, based on the micromanagement element of the ordinary business ground for exclusion, of proposals requesting companies to adopt timeframes or targets to address climate change. An example is a shareholder proposal requesting a company to prepare a report on the feasibility of achieving net-zero emissions by 2030, where the SEC staff concurred that such a proposal would constitute micromanagement of the company.[7] SLB 14L stated that relief will not be granted for the exclusion of similar proposals suggesting targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals.

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6 SLB 14L also contained clarifications and guidance related to the use of graphics in proposals, proof of ownership letters and email delivery confirmations.

7 Refer to the no-action letter dated March 6, 2018 (accessible here).

This approach has been reflected in recent responses from the SEC staff denying relief on the ordinary business ground for exclusion, despite relief having been granted in prior years for similar proposals. For example, relief was denied for a proposal requesting the preparation of a report reviewing a company's retirement plan options and the board of directors' assessment of how the company's current retirement plan options aligned with its climate action goals.[8] Relief was granted in earlier years, however, for the exclusion of similar proposals addressing both executive and non-executive compensation.[9]

Economic Relevance

The economic relevance ground for exclusion permits a company to exclude a shareholder proposal that (1) relates to operations which account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year and (2) is not otherwise significantly related to the company's business.

In SLB 14L, the Staff narrowed its interpretation of the economic relevance ground for exclusion, noting that proposals which raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the operations in question do not satisfy the economic thresholds noted in the ground for exclusion.

Substantial Implementation

The substantial implementation ground for exclusion permits exclusion of a shareholder proposal if the company has already "substantially implemented" the proposal. For example, relief was granted for the exclusion of a shareholder proposal requesting annual elections of directors in circumstances where the company had already planned to propose amendments to its organizational documents to phase out its classified board structure.[10]

Following SLB 14L, the SEC staff has applied a particularly restrictive interpretation of the substantial implementation ground for exclusion, denying relief for proposals where companies had implemented all but exactly what was requested in the relevant proposals, seemingly requiring near exact and complete implementation, rather than substantial implementation. As a result, some requests for relief to exclude proposals were denied despite relief having been granted in prior years, including, for example, a proposal requesting a company to report on the extent to which its business plans with respect to electric vehicles may involve, rely on or depend on child labor outside the

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8 Refer to the no-action letter dated April 8, 2022 (accessible here).

9 Refer to the no-action letter dated February 24, 2015 (accessible here) and the no-action letter dated March 28, 2012 (accessible here).

10 Refer to the final materials relating to a no-action request dated March 10, 2020 (accessible here).

United States. In that instance, although the company had publicly disclosed in its supplier code a zero tolerance policy regarding the use of child labor, and had publicly disclosed in a sustainability report that it monitored ethical behavior of its suppliers, especially around issues such as child labor and forced or slave labor, the SEC found that those public disclosures had not in fact substantially implemented the proposal.[11]

Under the SEC's proposed amendments to Rule 14a-8, the substantial implementation ground for exclusion would apply only if a company has already implemented the "essential elements of the proposal" rather than "substantially implemented" the proposal. Accordingly, while every element of a proposal need not be implemented, every "essential" element requires implementation in order for the shareholder proposal to be excluded on this basis.

Duplication

The duplication ground for exclusion permits a company to exclude a shareholder proposal that "substantially duplicates" a shareholder proposal already received by the company and which will be included in the company's proxy statement for the same meeting. For example, the SEC staff granted relief for the exclusion of a shareholder proposal requesting a report on the extent to which a company's products were produced through the use of forced (or slave) labor, with the SEC staff concurring that the proposal was duplicative of a proposal requesting the preparation of a report on the extent to which the company's policies and procedures protected workers in its supply chain from forced labor.[12] On the other hand, the SEC staff deemed a proposal requesting a report on whether a company's health and safety practices gave rise to racial and gender disparities in workplace injury rates, and the impact of any such disparities on the long-term earnings and career advancement potential of certain female and minority employees, not to be duplicative of a proposal requesting a racial equity audit analyzing the company's impacts on civil rights, equity, diversity and inclusion.[13]

Under the SEC's proposed amendments, the duplication ground would permit exclusion only if a proposal "addresses the same subject matter and seeks the same objective by the same means" as another proposal.

Resubmission

The resubmission ground for exclusion permits a company to exclude a shareholder proposal that addresses "substantially the same subject matter" as a proposal included in

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[11] Refer to the no-action letter dated April 18, 2022 (accessible here).

[12] Refer to the no-action letter dated December 20, 2021 (accessible here).

[13] Refer to the no-action letter dated April 7, 2022 (accessible here).

the company's proxy statement within the preceding five years if the matter was voted on and received support below specified voting thresholds on its most recent vote.[14] The proposed amendments would change this standard from "substantially the same subject matter" as another proposal to "substantially duplicates" another proposal.

Key Considerations for Shareholder Proposals

In light of the increased reluctance of the SEC staff to allow companies to exclude shareholder proposals on substantive grounds, and the increased shareholder focus on governance and social matters, public companies are advised to prepare for more shareholder proposals submitted under Rule 14a-8.

Engage with Shareholders

The benefits of consistent and robust shareholder engagement are well documented, but they are particularly meaningful in relation to shareholder proposals. First, dialogue with shareholders allows a company to have a clearer view of shareholder positions on corporate governance matters ahead of receiving any shareholder proposals. Shareholder engagement allows companies to solicit feedback on general market trends on governance and social matters, particularly those that may be relevant to the company's specific industry and shareholder base or that are of interest to proxy advisory firms. Active engagement may also encourage shareholders to informally express concerns to the company, rather than utilizing the abrupt and formal means of submitting a shareholder proposal under Rule 14a-8. By cultivating lines of open communication, the company is likely to gain greater insight into shareholder views, which could result in the company proactively and voluntarily adopting or amending policies that avoid contentious shareholder proposals and votes.

If a shareholder proposal is received, a company should consider responding first by contacting, and aiming to commence a constructive dialogue with, the proponent to discuss the concerns, subject matter, and objectives underlying the proposal. The company should explore whether there might be alternatives that would sufficiently address the proponent's concerns without the need for a formal shareholder proposal, such as the adoption of company policies on the topic or amending bylaws that do not require a shareholder vote.[15] While the ultimate utility of such a dialogue will depend on the nature of the proposal and motivations of the proponent, it is a low-cost and low-risk way to potentially avoid the reputational harm and perception of a misalignment

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14 Less than 5% of votes cast if previously voted on once; less than 15% of votes cast if previously voted on twice; or less than 25% if previously voted on more than three times.

15 In such event, the shareholder proposal would need to be formally withdrawn by the proponent in order to be excluded from the company's proxy statement.

with shareholder interests that are often associated with excluding or opposing shareholder proposals.

Ensure the Proposal (and the Company) Gets the Details Right

If a shareholder proposal cannot be dealt with outside the formal Rule 14a-8 process, the next step for a company is to evaluate whether the proposal meets the procedural and eligibility requirements of Rule 14a-8. The first checkpoint for analysis is whether the proposal was received by the deadline and whether the shareholder meets the eligibility requirements under Rule 14a-8. However, in order to exclude a proposal that fails to meet such requirements, a company must notify a shareholder of any procedural or eligibility defects within 14 days from receiving a proposal.[16] Accordingly, it is critically important that the physical and electronic mailboxes designated by the company to receive shareholder proposals be carefully monitored.

A company should note the SEC staff's guidance when notifying a shareholder of a perceived eligibility or procedural defect, such as providing adequate detail about what the shareholder must do to remedy the defect, including a copy of Rule 14a-8, providing the deadline by which the shareholder is to respond to the notice, and transmitting the notice in a manner that allows the company to determine when it is received by the shareholder.

Understanding Whether a Company Can (or Should) Seek Exclusion on Substantive Grounds

If a proposal meets the procedural and eligibility requirements of Rule 14a-8, a company should then consider whether it can and should request no-action relief to exclude the proposal on grounds of one of the 13 substantive bases under Rule 14a-8. Companies and their counsel are able to evaluate the likelihood of receiving no-action relief by reviewing the SEC's website, which catalogues its prior decisions (bearing in mind the SEC's current views of the substantially implemented, duplication and resubmission grounds for exclusions described above, and, in particular, the increased weight given to proposals relating to issues of broad societal impact).

Even if it might be possible to seek exclusion, companies should evaluate the potential reputational risks associated with seeking to exclude a shareholder proposal. A company's request for no-action relief, and related correspondence with the SEC staff, will eventually be made publicly available. Therefore, a company will need to weigh the risk of being perceived as not addressing the concerns of shareholders against the

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[16] A company need not provide the proponent shareholder such notice of a deficiency if the deficiency cannot be remedied, such as if the shareholder fails to submit a proposal by the company's properly determined deadline.

benefit of retaining current governance or operational practices that it might view as being in the best interests of the company and its shareholders.

Address Proposals Included in a Proxy Statement

If a shareholder proposal is included in a proxy statement,[17] a company may include in its proxy statement the reasons why it believes shareholders should vote against the proposal. This "statement in opposition" must be provided to the proponent shareholder no later than 30 days before the company files its definitive proxy statement.[18] As with seeking exclusions, there are potential reputational risks in publicly opposing a shareholder proposal that might in fact be supported by other shareholders. Further, if the proponent believes the company's statement in opposition is materially false or misleading, it may send a letter to the SEC staff and the company explaining its views (which would also eventually become public), which could further exacerbate the situation.

A company may also include a competing proposal in its proxy statement as an alternative to one or more shareholder proposals. This approach may mitigate some of the reputational risks associated with seeking to exclude a shareholder proposal received, as it demonstrates the company's willingness to address the concerns of shareholders while allowing the company to retain control of the implementation of the particular measure.

Finally, a company should consider what other disclosures it will include in the proxy statement relating to a shareholder proposal under Rule 14a-8. For example, a company is not required to, but may, disclose the identity and address of the proponent.

After the Meeting

If a shareholder proposal in a proxy statement receives the support of the requisite shareholders at the shareholder meeting, the company will then need to determine how or whether to implement the proposal, particularly given most proposals are not self-executing. For example, for a shareholder proposal that requests that the company take action to amend the company's certificate of incorporation, further board action and shareholder approval will be required to effect the amendment. Other shareholder proposals may require the consent of third parties, or for the company to adopt policies or take other action, the details of which may not be included or adequately described in the proposal. In taking such actions, the company should gain the support of shareholders on the topic, as well as other interested stakeholders.

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[17] Note that a Rule 14a-8 shareholder proposal will not trigger a requirement to file a preliminary proxy statement.

[18] If the proponent shareholder is required by the SEC staff to submit a revised proposal pursuant to a no-action letter, the statement in opposition must be provided to the shareholder within five days following receipt of the revised proposal.

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Please do not hesitate to contact us with any questions.

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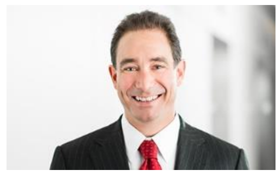

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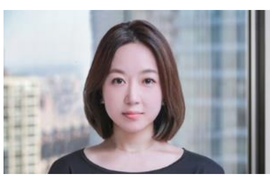

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