

SEC Proposes Amendments to Proxy Solicitation and Shareholder Proposal Rules

November 11, 2019

Capital Markets and Securities

On November 5, 2019, the Securities and Exchange Commission (SEC) proposed two rule amendments as part of its ongoing effort to modernize and improve the proxy voting system. The SEC proposed [amendments to its rules governing proxy solicitations](#) to clarify the application of such rules to proxy advisory firms making voting recommendations and to impose new disclosure and other obligations on such firms, with the goal of enhancing the accuracy, transparency and effectiveness of proxy voting advice. Separately, the SEC proposed [amendments to its shareholder proposal rule, Rule 14a-8 under the Securities Exchange Act of 1934](#) (Exchange Act), to tighten the eligibility criteria for shareholders seeking to have proposals included in a company's proxy materials.

SEC Chairman Jay Clayton praised the proposed amendments to the proxy solicitation rules, noting the increasingly important role played by proxy advisory firms, especially for "Main Street investors – who, more and more, invest through funds where the asset managers rely on the advice, services and reports of proxy voting advice businesses." With respect to the proposed amendments to Rule 14a-8, Commissioner Elad Roisman, who is taking a lead role in the SEC's focus on the proxy voting system, said the proposed changes "will facilitate and encourage meaningful company-shareholder engagement, and make changes that can help prevent misuse of the process." The SEC was divided on these rule proposals, however, both of which were approved by a 3-2 vote. In dissent, Commissioner Robert Jackson remarked that the changes would "limit public-company investors' ability to hold corporate insiders accountable," and Commissioner Allison Herren Lee stated that the proposals would "make it more costly and more difficult for shareholders to cast their votes or even to get their issues onto corporate ballots" and "would shift power away from shareholders and toward management."

The SEC's recent focus on the proxy process dates back to its 2010 [proxy plumbing Concept Release](#) and is a direct outgrowth of the SEC staff's [proxy process roundtable](#) in the fall of 2018 and recently issued interpretive guidance by the SEC to address investment advisers in fulfilling their [proxy voting responsibilities](#) and proxy advisory firms in providing [proxy voting advice](#). The two current proposals are further steps in the SEC's efforts to modernize and enhance the effectiveness of the proxy voting process in light of shifts in the way shares are held and traded and changes in the way public companies engage with shareholders.

Proposed Amendments to Proxy Solicitation Rules Relating to Proxy Voting Advice

Exempt Solicitation Rule: As further discussed below, the SEC regards voting recommendations of proxy advisory firms to be solicitations under the SEC's proxy rules. Proxy advisory firms, however, typically rely on Rules 14a-2(b)(1) and (3) under the Exchange Act for exemptions from the filing and disclosure requirements of the proxy rules.¹ The proposed amendments would revise these rules to condition reliance on these exemptions by proxy advisors on the following new requirements:

- **Disclosure of Material Conflicts of Interest:** Proxy advisors would be required to disclose material conflicts of interest in proxy voting advice, including:
 - any material interests, direct or indirect, of the proxy advisory firm (or its affiliates) in the matter or parties concerning which it is providing the advice;
 - any material transaction or relationship between the proxy advisory firm (or its affiliates) and (i) the company (or any of the company's affiliates) or (ii) a shareholder proponent (or its affiliates), in connection with the matter covered by the proxy voting advice;
 - any other information regarding the interest, transaction, or relationship of the proxy advisory firm (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship; and
 - any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction or relationship.
- **Company Review of Proxy Voting Advice:** A proxy advisory firm would be required to provide a company with an opportunity to review and comment on the firm's advice before the advice is issued,² with the length of the review and feedback period depending on how early the company files its definitive proxy statement.³ The proxy advisory firm would have complete discretion to decide whether to accept any requested

¹ Rule 14a-2(b)(1) exempts solicitations by persons who do not seek the power to act as a proxy for a shareholder and do not have substantial interest in the subject matter of the communication beyond their interest as a shareholder. Rule 14a-2(b)(3) exempts proxy voting advice furnished by an advisor to any other person with whom the advisor has a business relationship.

² The proposal would permit a proxy advisory firm to require a company and other soliciting persons to enter into confidentiality agreements for materials exchanged during the review and feedback period and would allow the proxy advisor to rely on the exemptions provided in Rule 14a-2(b)(1) and (3) where failure to comply with the new conditions was immaterial or unintentional.

³ The review and feedback period would need to be at least five business days if the definitive proxy statement is filed 45 or more calendar days before the shareholder meeting, and at least three business days if the definitive proxy statement is filed between 25 and 44 calendar days before the shareholder meeting. No review and feedback period would be required if the definitive proxy statement is filed less than 25 calendar days before the shareholder meeting.

revisions. The proposing release notes, however, that because the proxy voting advice constitutes a solicitation, it would remain subject to Rule 14a-9, which prohibits materially false or misleading misstatements or omissions in proxy solicitations.

- **Final Notice of Proxy Voting Advice:** The proxy advisory firm would also be required to provide a company with a final notice of its voting advice no later than two business days prior to the firm's delivery of that advice to its clients. If requested by the company, the proxy advisory firm would then be required to include a hyperlink directing the recipient to a written statement prepared by the company that sets forth its views on the advice. A company would be required to provide the hyperlink no later than the expiration of the two-business day final notice period referenced above. Any such hyperlinked statement of the company would itself constitute soliciting material that would be required to be filed as such by the company.

Amendments to Definition of "Solicitation" and Anti-Fraud Rule: The SEC also proposed the following amendments to Rule 14a-1(l) and Rule 14a-9 under the Exchange Act:

- **"Solicit" and "Solicitation" Definition:** The SEC is proposing to codify its interpretation that the definitions of "solicit" and "solicitation" in Rule 14a-1(l) include advice recommending how a shareholder should vote, or submit a consent or authorization on a specific matter, when the advice is furnished by a person that markets itself as a provider of such advice, separately from other forms of investment advice, and that sells such advice for a fee.
- **Anti-Fraud Considerations:** The SEC's proposal would add examples to Rule 14a-9 illustrating when the failure to disclose certain information along with proxy voting advice could be considered misleading. The proposed examples include failing to disclose the proxy advisory firm's sources of information, conflicts of interest or use of standards or requirements that materially differ from relevant standards or requirements set or approved by the SEC, such as the listing standards of national securities exchanges.

Transition Period: The SEC proposed to provide a one-year transition period after the publication of a final rule in the Federal Register to allow proxy advisory firms sufficient time to develop processes and systems to comply with the new requirements.

Proposed Amendments to Rule 14a-8

Rule 14a-8 under the Exchange Act requires a company subject to the SEC's proxy rules to include shareholder proposals in its proxy statement, as long as certain procedural requirements are satisfied, and subject to a company's right to exclude certain categories of proposals under substantive bases outlined in Rule 14a-8. The proposed amendments to Rule 14a-8 would tighten the eligibility criteria for shareholders to submit proposals and amend other elements of the rule to reduce avenues by which the rule could be abused.

Rule 14a-8(b) - Eligibility Requirements: The proposed amendments would revise certain requirements under Rule 14a-8(b) that a shareholder must satisfy to be eligible to have a proposal included in a company's proxy statement.⁴

- **Ownership Requirements:** In order to be eligible to submit a proposal, Rule 14a-8(b)(1) requires that a shareholder-proponent continuously hold at least \$2,000, or 1%, of a company's securities entitled to vote on the proposal at the meeting for at least one year by the date the proposal is submitted. The proposed amendments would eliminate the 1% threshold and implement the following tiered thresholds based on continuous ownership and length of ownership:
 - At least \$2,000 for at least three years;
 - At least \$15,000 for at least two years; or
 - At least \$25,000 for at least one year.⁵
- **Additional Documentation for Shareholder Representatives:** The proposed amendments would require shareholders that rely on a representative to submit a proposal to provide additional documentation. This would include authorizing documentation that indicates the shareholder's identity, role and interest in and support for a proposal and authorizes the representative to submit the proposal on the shareholder's behalf.
- **Mandatory Shareholder Engagement:** The proposed amendments would amend Rule 14a-8(b) to add a shareholder engagement component to the current eligibility criteria. Specifically, it would require shareholders to provide their availability to meet with the company, either in person or via teleconference, no less than 10 calendar days, nor more than 30 calendar days, after submission of the proposal. Shareholders would be required to provide contact information, as well as specific dates and times that the shareholder is available to discuss the proposal with the company.

Rule 14a-8(c) - One-Proposal Limit: Under the proposed amendments, a single "person," rather than "each shareholder" under current Rule 14a-8(c), may not submit multiple proposals at the same shareholders meeting. This would prevent a shareholder-proponent from submitting one proposal in his or her own name and simultaneously serving as a representative of another shareholder to submit a different proposal for consideration at the same shareholder meeting. Similarly, a representative would not be permitted to submit more than one proposal to be considered at the same shareholder meeting, even if the representative would be submitting each proposal on behalf of different shareholders.

⁴ The \$2,000 ownership threshold under Rule 14a-8(b) was last increased from \$1,000 by the SEC in 1998, and the resubmission thresholds under Rule 14a-8(i)(12) have been in place since 1954 and were last reviewed in 1998. See Amendments To Rules On Shareholder Proposals, Release No. 34-40018 (May 21, 1998) [63 FR 29106 (May 28, 1998)].

⁵ Under the proposed amendments the value of a shareholder's holdings would be calculated based on the average of the bid and ask prices on any date within 60 calendar days before the date the shareholder submits the proposal. Under the proposed amendments shareholders would not be permitted to aggregate their holdings for purposes of satisfying the minimum ownership requirements of Rule 14a-8(b) to submit a proposal.

Rule 14a-8(i)(12) - Resubmission Thresholds: Rule 14a-8(i)(12) permits a company to exclude a shareholder proposal that “deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company’s proxy materials within the preceding 5 calendar years” if the matter was voted on at least once in the least three years and did not receive a certain level of shareholder support.

- **Increased Resubmission Thresholds:** The current resubmission thresholds of 3%, 6% and 10% of the votes cast for matters voted on once, twice or three or more times in the last five years, respectively, would be increased to 5%, 15% and 25% of the votes cast, respectively;
- **Decline in Shareholder Support:** The SEC also proposed to add a new provision to Rule 14a-8(i)(12) that would permit a company to exclude a proposal where shareholder support for the matter has declined over the years. For example, a company would be permitted to exclude a proposal that has been submitted three or more times in the preceding five years that would not otherwise be excludable under the 25% threshold noted above, if:
 - the proposal received less than 50% of the votes cast; and
 - shareholder support for the proposal declined by 10% or more compared to the last time the shareholders voted on a proposal, involving substantially the same subject matter.

What Happens Next?

The proposed amendments are subject to 60-day comment periods that will begin when they are published in the Federal Register. It is unlikely that the proposed amendments will be finalized and adopted in time for the upcoming 2020 proxy season. These proposed amendments are part of the SEC’s larger work-stream to update and modernize the proxy system, however, and more is expected in the near term. In his opening statement for the consideration of the proposed amendments, Chairman Clayton [stated](#) that he expects the SEC to next address “proxy plumbing” and “universal proxy” rules.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Capital Markets and Securities practice:

David Martin	+1 202 662 5128	dmartin@cov.com
David Engvall	+1 202 662 5307	dengvall@cov.com
Matt Franker	+1 202 662 5895	mfranker@cov.com
Reid Hooper	+1 202 662 5984	rhooper@cov.com
Jenny O'Shanick	+1 202 662 5411	joshanick@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.