SEC's Shareholder Proposal Change May Muddle 2020 Proxies

By Joseph Hall, Ning Chiu and Betty Huber (September 13, 2019)

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On Sept. 6, the U.S. Securities and Exchange Commission staff announced a significant policy change to its administration of the shareholder proposal rule, Rule 14a-8 under the Securities Exchange Act of 1934.

When a company seeks to exclude a shareholder proposal by submitting a no-action request relying on one of the grounds for exclusion outlined in the rule, the staff will continue with its practice of reviewing the request. However, under the new policy, instead of responding in writing that it effectively agrees or disagrees with the company's rationale, in some cases the staff may respond only orally.

The staff may also decline to state a view with respect to the company's rationale, and may convey this decision orally. In this case, neither the company nor the proponent is to interpret the staff's reaction as indicating that the proposal should or should not be included in the proxy statement. Instead, the staff is simply saying that it is not weighing in on the merits.

As always, the parties may choose to seek resolution of the issue in court. The staff indicated it will continue to provide written responses in cases where it believes doing so would provide value, as with more broadly applicable guidance about complying with Rule 14a-8.

The Rule 14a-8 process is already fraught with uncertainty due to the varying demands of proponents and the thicket of sometimes confusing precedents that make it difficult to predict a given proposal's chances. Particularly for larger companies who receive the bulk of Rule 14a-8 shareholder proposals, managing this process has always required the legal team to run several simultaneous tracks.

These can include informing management and the board; finding the right internal parties to address the proposal's subject matter; engaging with the proponent and sometimes multiple co-filers; and analyzing whether a legal basis for exclusion can be identified so that a staff decision can help determine the outcome. This activity occurs during a frenzied time that also includes year-end closing and work on the proxy statement and annual report.

Unfortunately, the staff's policy change only adds more complexity to the process. If it chooses to seek no-action relief, the company now must plan for the possibility of receiving only an oral response, which could yield a disagreement with the proponent over just what the staff said, or receiving no response at all. In judging how to proceed, the legal team will need to decide, and explain to the board and management, whether to spend time and resources drafting a no-action request that could be for naught if the staff declines to respond.

We expect that where the staff declines to take a position, some companies may be hesitant to exclude the shareholder proposal from their proxy statements until there is clarity around whether negative consequences will flow from proxy advisers or other shareholders. While the new policy suggests litigation as an alternative, the cost and timing during the compressed proxy season time frame would likely be a deterrent — although a company that does in fact exclude a proposal in the face of the staff's silence may risk a late-breaking lawsuit from the proponent.

And while the announcement reiterates the staff's view that the board's own analysis of the company's grounds for exclusion can usefully inform the staff's response, given the limited success of this approach during the past two proxy seasons, the new policy could further discourage companies from engaging their boards for this purpose.

The staff's announcement does not provide specific details on how it will convey oral responses. While the announcement states that the staff will inform the proponent and the company of its position, it is unclear whether oral responses will be made publicly available, in summary or other form, so they can be used as precedents by other companies.

Currently, since many companies receive nearly identical proposals, companies with later annual meetings benefit from learning of the outcome of staff decisions earlier in the season since they are posted to the SEC's website on a relatively real-time basis. This was a game changer a few years ago when the staff decided that a company's voluntary adoption of a certain form of proxy access would allow it to exclude alternative forms pushed by proponents, and many companies wrote no-action requests after those initial decisions were made. If oral determinations are not made public, companies may suffer strategically if unaware of how the staff has decided to handle nearly identical proposals served to others.

Part of the impetus for this policy change may be the concern identified by SEC Chairman Jay Clayton last September regarding limitations on the applicability of staff views. The chairman highlighted a distinction between staff statements and the commission's rules and regulations, emphasizing that staff positions are nonbinding and do not create enforceable legal rights or obligations.

Commissioner Hester Peirce went a step further earlier this year and analogized staff guidance, however necessary and important to the functioning of the SEC, as a body of secret law that binds market participants, but is immune to review. The Rule 14a-8 review process, which perhaps ironically now includes this new policy, has sometimes been identified as an example of quasi-legislative rulemaking at the staff level.

Whatever the catalyst, when the staff informally raised the possibility of taking this new approach to no-action requests a few months ago, both investors and companies raised numerous concerns about the change given the staff's long-standing and active role, however imperfect, as the arbiter of shareholder proposals, which historically has provided a level of certainty and finality that informs a complex process.

The full impact of this policy change is too early to gauge, but at a minimum the disposition of shareholder proposals in the 2020 proxy season may be more difficult for all parties — companies, their boards and management, proponents and, depending on the reaction of the proxy advisers, other voting shareholders.

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