

November 14, 2019

SEC Proposes Amendments to Proxy Solicitation and Shareholder Proposal Rules

Would Amend Exemptions from the Proxy Rules for Proxy Voting Advice and Revise Shareholder Proposal Eligibility and Resubmission Requirements

SUMMARY

On November 5, 2019, the Securities and Exchange Commission took a further step in implementing its agenda for proxy reform, proposing amendments in two separate releases. The [first release](#) proposes amendments to the proxy solicitation rules with respect to proxy voting advice businesses, including new procedures for voting advice to qualify for the exemptions from the proxy information and filings requirements. The [second release](#) proposes amendments to the shareholder proposal rules to modernize the submission and resubmission requirements and to update procedural requirements. Both releases were approved by a 3-to-2 vote, with Commissioners Jackson and Lee dissenting. Public comments on the proposed amendments are due within 60 days after publication of the proposed amendments in the Federal Register.

BACKGROUND

On August 21, 2019, the SEC's Division of Corporation Finance issued proxy rule guidance¹ clarifying that proxy voting advice issued by proxy advisory firms generally constitutes a "solicitation" under Exchange Act Rule 14a-1(l) and that the antifraud provisions in Exchange Act Rule 14a-9 apply to proxy voting advice (which prohibits any solicitation from containing any statement which, at the time and in the light of the circumstances under which it is made, is "false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or

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misleading or necessary to correct any statement in any earlier communication with respect to the solicitation”). The proxy rule guidance also clarified that opinions, reasons, recommendations and beliefs that are disclosed as part of a solicitation may constitute “material facts” under Exchange Act Rule 14a-9 and that their underlying facts, assumptions, limitations and other information may need to be disclosed.. The guidance did not restrict the ability of proxy advisory firms to rely on any applicable exemptions from the information and filing requirements of the federal proxy rules set forth in Exchange Act Rule 14a-2(b).

The SEC approved the guidance by a 3-to-2 vote, with Commissioners Jackson and Lee dissenting. In that meeting, the SEC noted that it could supplement the guidance as part of its review of the overall proxy process and that the SEC Staff was considering recommending rule amendments to address proxy advisory firms’ reliance on proxy solicitation exemptions.

On October 31, 2019, shareholder advisory firm Institutional Shareholder Services Inc. filed a lawsuit in the U.S. District Court for the District of Columbia asserting that the guidance is “unlawful” and “arbitrary and capricious” and should be rescinded.² ISS also asserts that the guidance is invalid because it was not approved after a notice-and-comment period. The suit was strategically timed, as the SEC was already set to meet on November 5 to determine whether or not to propose amendments affecting proxy advisors and shareholder proposals. The suit is also the second time this year that parties subject to regulation by the SEC have filed suit to stop such actions, potentially reflecting a trend as the SEC continues to engage in regulatory reforms.

Separately, on September 6, 2019, the SEC’s Division of Corporation Finance announced two changes regarding its administration of Exchange Act Rule 14a-8, which governs shareholder proposals.³ The SEC stated that, starting with the 2019-2020 shareholder proposal season, the SEC may (1) respond orally instead of in writing to no-action requests and (2) decline to state a view with respect to some no-action requests. Where the SEC declines to state a view, interested parties were told not to interpret that position as a requirement that a shareholder proposal be included in a proxy statement.

PROPOSED AMENDMENTS

In light of these developments, on November 5, the SEC proposed the amendments affecting the rules governing proxy voting advice and shareholder proposals contained in the two aforementioned releases.

Proposed Amendments to the SEC’s Proxy Voting Advice Rules

The SEC’s proposed amendments to the proxy voting advice rules would codify its interpretation that proxy voting advice generally constitutes a “solicitation,” establish new procedural requirements and add illustrative examples of when failure to disclose information in proxy voting advice may violate the anti-fraud provisions.

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Definition of “Solicitation”

The proposed amendments would revise Exchange Act Rule 14a-1(l) to make clear that a solicitation includes 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. The proposed amendments would also codify the existing SEC view that voting advice in response to unsolicited inquiries would not constitute a solicitation. These proposed revisions are based on the dual beliefs that (1) the furnishing of proxy voting advice by a person who has decided to offer such advice, separately from other forms of investment advice, to shareholders for a fee, with the expectation that its advice will be part of the shareholders’ voting decision-making process, is conducting the type of activity that raises the investor protection concerns about inadequate or materially misleading disclosures that the SEC’s proxy rules are intended to address and (2) providing voting advice to a client where the client’s request for the advice has been invited and encouraged by the person’s marketing, offering and selling such advice should be distinguished from advice provided by a person only in response to an unprompted request from its client.

Procedural Requirements

The proposed amendments would establish new procedural requirements in order for proxy voting advice to qualify for the existing Exchange Act exemptions from the proxy information and filings requirements.

Under the current versions of Rule 14a-2(b)(1) and (b)(3), two types of communications are generally exempt from the proxy rules (subject to certain limits and conditions): (1) solicitations by persons who do not seek the power to act as proxy for a shareholder and do not have a substantial interest in the subject matter of the communication; and (2) proxy voting advice furnished by an advisor to any person with whom the advisor has a business relationship.

The SEC’s proposed amendments provide that these exemptions will only be available to a proxy voting advice business if three procedural requirements are satisfied. First, the firm must include disclosure of material conflicts of interest in its proxy voting advice and any electronic medium used to deliver the advice. This disclosure would include any material transaction or relationship with the issuer, any other soliciting person and any involved shareholder proposal and any other information material to assessing the objectivity of the advice in light of the circumstances of any specific conflict. Second, the issuer covered by the proxy voting advice and any other soliciting persons must be given an opportunity to review and provide feedback on the advice before it is issued, with the length of review dependent on the number of days between filing of the definitive proxy statement and the date of the shareholder meeting. If an issuer files its proxy statement less than 45 but at least 25 calendar days before the date of its shareholder meeting, the proxy advisor would be required to provide at least three business days to review any proxy voting advice. If an issuer files its proxy statement 45 calendar days or more before the date of its shareholder meeting, the proxy advisor would be required to provide at least five business days

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to review any proxy voting advice. Third, if requested by the issuer covered by the proxy voting advice or other soliciting persons, the firm must include in its advice and any electronic medium used to deliver the advice a hyperlink directing the recipient to a written statement that sets forth the registrant's or soliciting person's views on the proxy voting advice. The proxy advisor must give its final advice to the issuer and any other soliciting person two business days in advance of distribution (in order to permit the development of the response). The proxy advisor could require a confidentiality agreement no more restrictive than required of its clients in connection with the review process. There would be no review and feedback period or opportunity to request inclusion of a hyperlink for an issuer that filed its proxy statement less than 25 calendar days prior to the shareholder meeting.

Inclusion of Examples in the Anti-Fraud Provisions

The anti-fraud rules in Exchange Act Rule 14a-9 still apply to solicitations that are exempt from the proxy rule information and filing requirements. The SEC's proposed amendments modify the anti-fraud provisions in Rule 14a-9 to include examples of when the failure to disclose information in the proxy advice could, depending upon the particular facts and circumstances, be considered misleading within the meaning of the rule. These examples include the failure to disclose the proxy voting advice business's methodology, sources of information, conflicts of interest or use of standards (such as for director independence) that materially differ from relevant standards or requirements that the SEC sets or approves.

Proposed Amendments to the Shareholder Proposal Rules

The SEC's proposed amendments to the shareholder proposal rule, Exchange Act Rule 14a-8, would affect the eligibility of a shareholder to submit a proposal, the number of proposals that may be submitted and the thresholds an unsuccessful proposal must achieve to be resubmitted.

Eligibility to Submit a Shareholder Proposal.

Under the current version of Rule 14a-8(b), in order to submit a proposal to a company to include in its proxy statement, a shareholder must have continuously held at least \$2,000, or 1%, of the company's securities for at least one year. The SEC observed that this threshold, which was established in 1998, does not strike the appropriate balance in 2019, when five shareholders accounted for 31% of all shareholder proposals submitted for the year.⁴ The SEC's proposed amendments would eliminate the 1% ownership threshold and introduce a three-tiered approach to determining when shareholders are eligible to submit proposals to a company. A shareholder is eligible to submit proposals if it has continuously held (a) at least \$2,000 of the company's securities for at least three years; (b) at least \$15,000 of the company's securities for at least two years ; or (c) at least \$25,000 of the company's securities for at least one year. Shareholders would also no longer be permitted to aggregate security ownership to satisfy eligibility.

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The proposed amendments would also require certain documentation when a proposal is submitted by a representative on behalf of a shareholder proponent. Specifically, the shareholder would be required to provide the company with written documentation that: (a) identifies the company to which the proposal is directed; (b) identifies the annual or special meeting for which the proposal is submitted; (c) identifies the shareholder as the proponent and identifies the person acting on the proponent's behalf as the proponent's representative; (d) includes a statement authorizing the designated representative to submit and proposal and/or otherwise act on the proponent's behalf; (e) identifies the specific proposal to be submitted; (f) includes the proponent's statement supporting the proposal; and (g) is signed and dated by the proponent. Additionally, the shareholder proponent must state that it is available to meet with the company in person or via teleconference at least ten, but no more than 30, days before the shareholder meeting, and must provide the business days and specific times that the proponent is available to discuss the proposal with the company.

Limit on Number of Proposals

Under the current version of Rule 14a-8(c), each shareholder may only submit one proposal to a company for a particular shareholders meeting. The proposed amendment would change the language of Rule 14a-8(c) to impose the limit on "persons" rather than "shareholders" so that the same representative may not submit multiple proposals for the same meeting in the name of different shareholder proponents.

Proposed Resubmission Thresholds

The proposed amendments would modify the thresholds an unsuccessful shareholder proposal must surpass under Rule 14a-8(i)(12) for resubmission. Under current Rule 14a-8(i)(12), a company may exclude a shareholder proposal that deals with substantially the same subject matter as another proposal or proposals that have been previously included in the company's proxy materials if the proposal received: (a) less than 3% of the vote if proposed once within the preceding five calendar years; (b) less than 6% of the vote on its last submission to shareholders if proposed twice within the preceding five calendar years; or (c) less than 10% of the vote on its last submission to shareholders if proposed three times or more previously within the preceding five calendar years. The SEC's proposed amendments would change those thresholds so that a company may now exclude a shareholder proposal if the proposal received (a) less than 5% of the vote if proposed once within the preceding five calendar years; (b) less than 15% of the vote on its last submission to shareholders if proposed twice within the preceding five calendar years; or (c) less than 25% of the vote on its last submission to shareholders if proposed three times or more previously within the preceding five calendar years. Additionally, even if a shareholder proposal that has been submitted more than three times within the preceding five years has received more than 25% of the vote on its last submission to shareholders, it may be excluded if at the most recent shareholder vote it received less than 50% of the votes cast and the percentage of votes cast

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declined by 10% or more compared to the immediately preceding vote on substantially the same subject matter.

NEXT STEPS

The public comment period will be open for 60 days after publication of the proposed amendments in the Federal Register.

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ENDNOTES

- ¹ The release is available at <https://www.sec.gov/rules/interp/2019/34-86721.pdf>. S&C's memorandum to clients on this release is available at <https://www.sullcrom.com/files/upload/SC-Publication-SEC-Takes-First-Step-on-Proxy-Reform.pdf>.
- ² *ISS v. SEC*, D.D.C., No. 1:19-cv-03275, 10/31/19.
- ³ The SEC announcement is available at <https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests>.
- ⁴ S&C's memorandum for clients on shareholder proposals during the 2019 proxy season is available at <https://www.sullcrom.com/files/upload/SC-Publication-2019-Proxy-Season-Review-Part-1-Rule-14a-8-Shareholder-Proposals.pdf>.

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