

Shareholder Proposals: Strategies and Tactics

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Introduction



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Overview

- Shareholder Proposal Basics
- Steps to Take after Receiving a Shareholder Proposal
- Bases and Process for Excluding a Shareholder Proposal
- Process for Including a Shareholder Proposal
- 2016 Proxy Season Highlights
- 2017 Proxy Season Trends and Developments

Overview

Shareholders of a public company may seek to have matters acted on by the board and/or management at an annual or special meeting of shareholders.

- **What laws and rules control shareholder proposals?**
 - Proposals *outside of* a company's proxy statement must be submitted in accordance with state corporation laws and a company's organizational documents (advance notice bylaws).
 - Proposals *included in* the company's proxy statement must comply with Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the "Exchange Act").
- **When can shareholder proposals bind the company?**
 - Proposals are typically non-binding (precatory), because under typical state corporation law, shareholders do not have the power to require the board to take action on the basis that it would interfere with the board's ability to govern the affairs of the corporation.
 - Shareholders may invoke their power under state law to adopt bylaws in order to make binding proposals (e.g., Delaware permits adoption of majority voting for directors through bylaw amendment).

Shareholder Proposal Basics

- **Who is eligible to submit proposals for inclusion in company proxy statements?**
 - Shareholder proposals may be filed only by an investor who has held at least \$2,000 worth of the company's stock or 1 percent of the shares eligible to vote (whichever figure is smaller) continuously for at least one year before the date the proposal is submitted to the company. (*Rule 14a-8(b)*)
 - Proof of ownership must be registered on the company's records, a written statement from a record holder (DTC participant) or a 13D/G or Form 4/5 filing.
 - Proof must be as of the date that the proposal is submitted.
 - What about proponents who do not own shares but act on behalf of a shareholder? SEC has refused to grant no-action relief when companies have sought to exclude proposals on this basis.
 - The proponent must pledge to continue to hold the securities through the date of the annual meeting, not just the record date for the meeting.
- **When must the proposal be submitted?**

Typically, shareholders must submit the proposal by the deadline disclosed in last year's proxy statement (at least 120 days before the date of the company's proxy statement for the previous year's annual meeting). (*Rule 14a-8(e)*)
- **Must a company accept a revised proposal?**

Only if the revised proposal is submitted before the deadline for shareholder proposals.

Steps to Take After Receiving a Shareholder Proposal

- **Establish key deadlines for responding to the proposal**

(See sample timeline).
- **Confirm the proponent's eligibility and procedural compliance with proxy rules:**
 - Compliance with ownership and timeliness requirements discussed above.
 - One proposal per shareholder for a particular shareholders' meeting. (*Rule 14a-8(c)*)
 - Proposal (plus accompanying supporting statement) may not exceed 500 words. (*Rule 14a-8(d)*)
 - The company must notify the proponent of any deficiencies and a timeframe for response within 14 days of receipt of the proposal. (*Rule 14a-8(f)*)
 - If the proponent fails to respond within 14 days of receiving the company's notice, the company may then submit a no-action letter requesting the right to exclude the proposal.
 - Notice does not need to be given for deficiencies that cannot be remedied, such as failure to meet the proposal deadline.

Steps to Take After Receiving a Shareholder Proposal

- **Do websites count against a proposal's word limit?**

No, a reference to a website address counts as one word, but may be excluded under Rule 14a-8(i)(3) "if the information contained on the website is materially false or misleading, irrelevant to the subject matter of the proposal or otherwise in contravention of the proxy rules, including Rule 14a-9."
(SLB 14G)

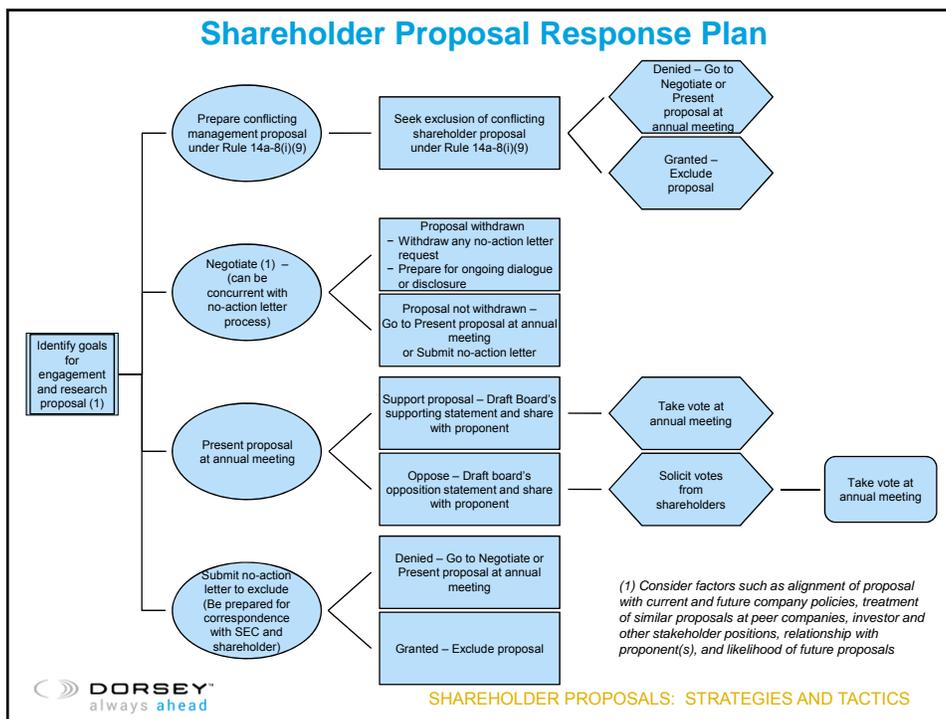
- **Do graphics count against a proposal's word limit?**

No, shareholders are entitled to use graphics without having them applied against the 500-word limit, but the Staff of the SEC's Division of Corporation Finance (the "Staff") will look at graphics on a case by case basis, and may prohibit them on the basis that they are false and misleading, irrelevant or impugn character.
(Staff's June 30, 2016 Rule 14a-8 Stakeholder Meeting)

Steps to Take After Receiving a Shareholder Proposal

- **Identify goals for the shareholder engagement**

- Advance the company's position on the issue
- Strengthen relationship and reputation with shareholders
- Collaborate with shareholders on further study of the proposal
- Discourage future proposals
- Minimize disruption to board and management processes



Excluding a Shareholder Proposal

- **Shareholder proposals may be excluded for eligibility or procedural deficiencies discussed above. There are also 13 substantive bases for exclusion under Rule 14a-8.**
- **Some commonly cited grounds for exclusion are:**
 - **Violation of proxy rules (Rule 14a-8(i)(3)):** e.g., the company demonstrates objectively that a factual statement is materially false or misleading, or the resolution is so inherently vague or indefinite that neither the shareholders voting on the proposal, nor the company implementing the proposal (if adopted) would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires.
 - **Ordinary business operations (Rule 14a-8(i)(7)):** the proposal deals with a matter relating to the company's ordinary business operations.
 - **Substantial implementation (Rule 14a-8(i)(10)):** the company has already substantially implemented the proposal.

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Excluding a Shareholder Proposal

- **The other grounds for excluding proposals:**
 - Improper subject for action by shareholders under state law (*Rule 14a-8(i)(1)*)
 - Violation of law (*Rule 14a-8(i)(2)*)
 - Relates to a personal grievance or special interest (*Rule 14a-8(i)(4)*)
 - Insignificant relationship to company's business (*Rule 14a-8(i)(5)*)
 - Lack of power or authority of the company to implement the proposal (*Rule 14a-8(i)(6)*)
 - Relates to a specific director election (*Rule 14a-8(i)(8)*)
 - Conflicts with the company's proposal (*Rule 14a-8(i)(9)*)
 - Substantially duplicates another proposal submitted by another shareholder (*Rule 14a-8(i)(11)*)
 - Resubmissions of certain prior proposals (*Rule 14a-8(i)(12)*)
 - Relates to specific amount of dividends (*Rule 14a-8(i)(13)*)

Excluding a Shareholder Proposal

- **To exclude a proposal, a company may submit a request for a no-action letter to the Staff of the SEC's Division of Corporation Finance (the "Staff"). More than one basis for exclusion may be, and often is, cited.**
- **A no-action letter from the Staff provides its informal view regarding whether it would recommend enforcement action to the SEC if the company takes the course of action described in the no-action letter request.**
- **A company must send the SEC a no-action letter request at least 80 days before the date it plans to mail its proxy statement to shareholders, and simultaneously provide a copy to the proponent. (*Rule 14a-8(j)*)**
- **The proponent may submit its own statement to the SEC. (*Rule 14a-8(k)*)**
- **The Staff will then consider all the arguments and issue a decision, typically within 30-60 days of receipt.**
- **Staff requests (*Staff's June 30, 2016 Rule 14a-8 Stakeholder Meeting*):**
 - Proponents, stop sending us so many complaints.
 - Don't copy us on correspondence between the proponents and companies.
 - Companies and law firms, stop calling us for a response on letter status unless there is an imminent print deadline.

Including a Shareholder Proposal

- **If the company includes the shareholder proposal in its proxy statement:**
 - Company must send a proponent a copy of its opposition statement no later than 30 days before it files its definitive proxy statement (or no later than 5 days after the company receives a revised proposal), and the proponent may challenge any false or misleading statements. *(Rule 14a-8(m)(3))*
 - The proxy statement must include the shareholder's name and address, as well as the number of the company's shares held. The company may instead include a statement that it will provide the information to shareholders promptly upon request. *(Rule 14a-8(l))*
 - If the proponent or a qualified representative fails to appear and present the proposal, without good cause, the company will be permitted to exclude all of the proponents proposals for any meetings held in the following two calendar years. *(Rule 14a-8(i)(2))*

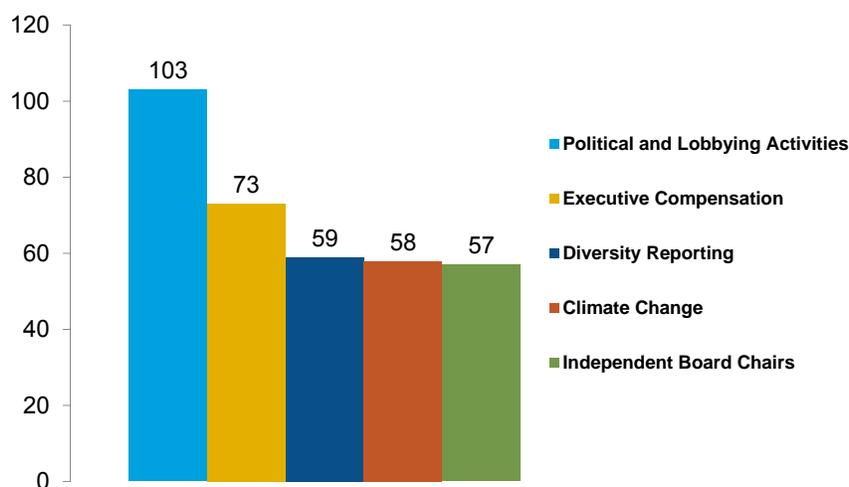
2016 Proxy Season Highlights

- **Overall, the total number of shareholder proposals submitted (916) was down from the all-time high in 2015 (943) but higher than in 2014 and 2013.**
- **Proxy access proposals continued to dominate the landscape of shareholder proposals for the second consecutive year. As of August 31, 39% of S&P 500 companies provide a proxy access right, and 264 U.S. companies in the Russell 3000 have adopted some form of proxy access.**
- **Although the average support for proxy access proposals declined to 49% in 2016 compared to 55% in 2015, shareholder proposals received majority support at 27 of the 58 companies at which the matter was put to a vote.**

2016 Proxy Season Highlights

- Shareholder proponents were much less successful in garnering majority support for proposals on other topics, but at least nine environmental and social proposals received majority support in 2016, including political spending disclosure (Fluor and NiSource), sustainability reporting (CLARCOR), board diversity (FleetCor Technologies and Joy Global), and non-discrimination proposals (JB Hunt Transport Services).
- As in prior years, many submitted proposals were not voted upon because they were withdrawn following discussions with the company or excluded pursuant to the SEC's no-action letter process.
- The Staff granted 143 (68%) of the no-action requests submitted during the 2016 proxy season, compared to 130 (61%) requests granted during the 2015 proxy season.

Following proxy access, the most common shareholder proposal topics in 2016



Staff Legal Bulletin 14H

Staff Legal Bulletin 14H (October 22, 2015) provided guidance on:

- The scope and application of the ordinary business exclusion under Rule 14a-8(i)(7) in light of *Trinity Wall Street v. Wal-Mart Stores, Inc.* and
- The scope and application of Rule 14a-8(i)(9): the basis for excluding a shareholder proposal that “directly conflicts with one of the company’s own proposals to be submitted to shareholders at the same meeting.”

Rule 14a-8(i)(7) – Ordinary Business Basis for Exclusion

Trinity Wall Street v. Wal-Mart Stores, Inc.

- The Third Circuit agreed with the SEC Staff’s conclusion that a proposal’s subject matter related to Wal-Mart’s ordinary business operations - specifically, “a potential change in the way Wal-Mart decides which products to sell.”
- The Third Circuit’s new two-part test as to whether the significant policy exception applied: does the proposal (1) transcend the day-to-day business matters of the company, meaning that it must be “divorced from how a company approaches the nitty-gritty of its core business” and (2) raise policy issues so significant that it would be appropriate for a shareholder vote.
- SEC Staff confirms its one-step approach whereby significant social policy issues by definition transcend ordinary business and are therefore not excludable.
- While it is rare for shareholders to go to court to overturn a no-action decision, it does happen. Courts are less deferential to Staff decisions versus a ruling by the Commissioners. But Staff may decide how broadly to apply the ruling to future no-action requests, because it has considerable latitude to interpret SEC rules.

Rule 14a-8(i)(7) – Ordinary Business Basis for Exclusion

- **What constitutes a significant policy issue?**
 - A matter of widespread public debate,
 - That includes legislative and executive attention, and
 - Press attention

(Staff's June 30, 2016 Rule 14a-8 Stakeholder Meeting)
- **Recent and popular significant policy issues**
 - At least nine environmental and social proposals received majority support in 2016, including political spending, sustainability reporting, and diversity and non-discrimination proposals
 - Proposal requesting a report detailing the known and potential risks and costs to the company caused by any enacted or proposed state policies supporting discrimination against LGBT people *(Procter & Gamble, August 16, 2016)*
 - Emerging: Reports on auditor rotation policies? With SEC encouragement, voluntary audit-related disclosures continue to trend upward.

Rule 14a-8(i)(9) - Conflicting Proposals Basis for Exclusion

- Rule 14a-8(i)(9) allows a company to exclude a shareholder proposal “if the proposal directly conflicts with one of the company’s own proposals to be submitted to shareholders at the same meeting.”
- Historically, conflicting proposals presented “alternative and conflicting decisions for the shareholders” and created the potential for “inconsistent and ambiguous results.”
- In January 2015, in response to companies’ attempts to exclude shareholder proxy access proposals by introducing competing management proposals, the Staff undertook to review the proper scope and application of Rule 14a-8(i)(9), and announced that it would express no view with respect to arguments under Rule 14a-8(i)(9) for the remainder of the proxy season.

Rule 14a-8(i)(9) - Conflicting Proposals Basis for Exclusion

- The Staff's new, more narrow approach under SLB 14H focuses on whether there is a direct conflict between the management and shareholder proposals.
- A direct conflict would exist if a reasonable shareholder could not logically vote in favor of both proposals (*i.e.*, a vote for one proposal is tantamount to a vote against the other proposal).

Rule 14a-8(i)(9) - Conflicting Proposals Basis for Exclusion

Examples of direct conflicts that may be excluded:

- A company seeks shareholder approval of a merger, and a shareholder proposal asks shareholders to vote against the merger.
- A shareholder proposal that asks for the separation of the company's chairman and CEO, and a management proposal seeking approval of a bylaw provision requiring the CEO to be the chair at all times.
- *Illumina, Inc. (March 18, 2016)*: A shareholder proposal that greater-than-simple-majority voting standards be eliminated, and a management proposal seeking approval of existing supermajority voting standards. It's still possible to craft management proposals that intentionally directly conflicts with shareholder proposals.

Examples of proposals that may not be excluded:

- A shareholder proposal that would permit a shareholder or group of shareholders holding at least 3% of the company's outstanding stock for at least 3 years to nominate up to 20% of the directors, and a management proposal would allow shareholders holding at least 5% of the company's stock for at least 5 years to nominate for inclusion in the company's proxy statement 10% of the directors.
- A shareholder proposal asking the compensation committee to implement a policy that equity awards would have no less than four-year annual vesting, and a management proposal to approve an incentive plan that gives the compensation committee discretion to set the vesting provisions for equity awards.

Rule 14a-8(i)(10) – Substantial Implementation Basis for Exclusion

- Rule 14a-8(i)(10) permits a company to exclude a shareholder proposal from its proxy materials if the company has “substantially implemented” the proposal.
- The rule was “designed to avoid the possibility of shareholders having to consider matters which have already been favorably acted upon by the management.” (*Release No. 34-12598, July 7, 1976*)

Substantial Implementation and Proxy Access

- Staff issued a series of no-action letters in February/March allowing companies to exclude proxy access proposals if they had adopted proxy access bylaws that fulfilled the “essential objective” of the shareholder proposal.
- At least 264 companies have adopted proxy access bylaws, with a majority adopting a “3/3/20/20” model permitting shareholders who continuously own 3% of shares outstanding for a 3-year period to nominate up to 20% of the board (and at least 2 directors). Under the bylaws, no more than 20 shareholders may aggregate their shares to reach the 3% ownership threshold.
- Certain investors continue to insist on “essential elements” of proxy access: that companies allow shareholders to nominate up to 25% of the board, or at least 2 directors; no shareholder aggregation limit; no renomination limit; and no 3-day deadline to recall loaned shares.
- SEC Staff has denied no-action relief on proposals to amend existing proxy access bylaws to reflect these terms (*H&R Block, Microsoft, Cisco, WD-40*).

Substantial Implementation and Proxy Access

Implications of the Staff's No-Action Responses

- On proposals for amendments, Staff has been unable to conclude that a company has “met its burden of establishing that it may exclude the proposal under Rule 14a-8(i)(10).”
- In light of ongoing debate over “essential elements” of proxy access, investors become the ultimate arbiters.
- Companies that have already adopted proxy access bylaws are likely to receive proposals for additional amendments in the coming proxy season.
- The H&R Block proposal received approximately 30% of votes cast.

Substantial Implementation and Proxy Access

ISS Policy on Proxy Access Restrictions

- If an implemented proxy access policy or management proxy access proposal contains restrictions or conditions on proxy access nominees, ISS will review the implementation and restrictions on a case-by-case basis. Certain restrictions viewed as potentially problematic especially when used in combination include, but are not limited to:
 - Prohibitions on resubmission of failed access nominees.
 - Restrictions on third-party compensation of access nominees.
 - Restrictions on the use of proxy access and proxy contest procedures for the same meeting.
 - How long and under what terms an elected access nominee will count towards the permitted number of access candidates.
 - When the access right will be fully implemented and accessible to qualifying shareholders.
- Two types of restrictions will be considered especially problematic because they are so restrictive as to effectively nullify the proxy access right:
 - Counting individual funds within a mutual fund family as separate shareholders for purposes of an aggregation limit.
 - The imposition of post-meeting shareholding requirements for nominating shareholders.

2017 Proxy Season Trends and Developments

Expect more proxy access proposals:

- Proposal to adopt proxy access bylaws at mid- and small-cap companies.
- Proposals to amend proxy access bylaw provisions:
 - Limiting shareholder aggregation.
 - Prohibiting proxy access and proxy contests at the same meeting.
 - Restricting the resubmission of failed nominees.
 - Reducing the maximum number of proxy access candidates by elected nominees.
 - Third-party compensation disclosure and restrictions.

2017 Proxy Season Trends and Developments

Investors will continue to focus on board diversity, refreshment and tenure:

- Board diversity proposals received majority votes at Joy Global and FleetCore Technologies in 2016.
- Thresholds were established:
 - CalPERS and Legal & General Investment Management adopted thresholds for excessive tenure (12 and 15 years, respectively), with CalPERS adopting a “comply or explain” approach.
 - State Street Global Advisors bases excessive tenure on market average.
 - BlackRock will only vote against directors with extended tenures only if there are perceived governance failings at the company.
- From the 2016 ISS Policy Survey:
 - 53% of investors identified an absence of newly-appointed independent directors in recent years as indicative of a problem.
 - 51% flagged lengthy average tenure as problematic.
 - 68% responded that a high proportion of directors with long tenure is cause for concern.

2017 Proxy Season Trends and Developments

Other proposals to expect:

- Proposals relating to governance, political and lobbying activities, executive compensation, diversity, climate change and other environmental issues will likely continue at similar levels experienced in 2018, with similarly low success rates.

CII majority voting initiative:

- Council of Institutional Investors sent letters to 186 Russell 1000 companies on August 1 urging them to adopt majority voting standards for uncontested election of directors.
- Resignation policy not sufficient.
- Will shareholder proposals follow?

Graphics: an emerging battleground?

2017 Proxy Season Trends and Developments

ISS and Glass Lewis stricter over-boarding limits take effect:

- Recommend a vote against a director who is an executive of a public company and is on more than two public company boards (including their own) and a director who is not an executive but serves on more than five public company boards (including their own).

Say-on-pay frequency comes to a vote:

- Approximately 80% of Russell 300 companies hold annual say-on-pay votes.
- From the ISS Policy Survey, 66% of investors favored annual say-on-pay votes.
- Say-on-pay lowest failure rate in five years in 2015.