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Corporate Governance & Compliance Group

Shareholder Proposals: Strategies and Tactics

September 26, 2019

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Materials

Shareholder Proposals: Trends, Strategies and Tactics

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Introduction

CAM HOANG
Cam, a Partner in our Capital Markets and Corporate Compliance Group, Cam helps clients with corporate matters including governance and SEC compliance, securities offerings, and mergers and acquisitions. Prior to her return to Dorsey, Cam was Senior Counsel and Assistant Secretary at General Mills, Inc., a multinational manufacturer and marketer of branded consumer foods. Before joining General Mills in 2005, Cam was an associate at Dorsey in Minneapolis. Cam is a co-editor of Dorsey's corporate governance and compliance blog, http://governancecomplianceinsider.com/. In 2017, she was named a Partner of the Year. hoang.cam@dorsey.com

GARY TYGESSON
Gary is Co-Chair of our Capital Markets and Corporate Compliance Group and has extensive experience advising public companies on a wide range of securities financing, reporting and compliance matters. Gary also regularly advises clients and their Boards of Directors with respect to corporate governance, SEC compliance, public company disclosure, shareholder activism and executive. Gary served as Co-Chair of the firm-wide Corporate Group from 1997 to 2002 and as a member of the Firm's Management Committee from 1997 to 2002. tygesson.gary@dorsey.com

TROY KELLER
Troy is Of Counsel in the Mergers & Acquisitions Group. Having worked both as external and internal legal counsel for a number of Fortune 500 companies, Troy brings the expertise and insights companies need to navigate today's challenges and opportunities. Troy recently joined Dorsey from Huntsman Corporation (NYSE: HUN), a global manufacturer and marketer of differentiated and specialty chemicals, where he served as Vice President and Associate General Counsel for over a decade. He led Huntsman's corporate legal team for many years and most recently headed its government affairs function. Prior to Huntsman, Troy was in-house securities law counsel at Qwest Communications, a leader in the telecommunications industry. Troy has significant international experience, as well as industry knowledge in the telecommunications, materials sciences and chemical industries. keller.troy@dorsey.com

Overview

- **2019 Proxy Season Trends and Developments**
- **Expectations for 2020 Proxy Season**
- **Process for Responding to a Shareholder Proposal**
- **Shareholder Proposal Basics (Appendix)**

Except as otherwise stated, statistics in this presentation are derived from ISS reporting for the period between October 1, 2018 and July 1, 2019.

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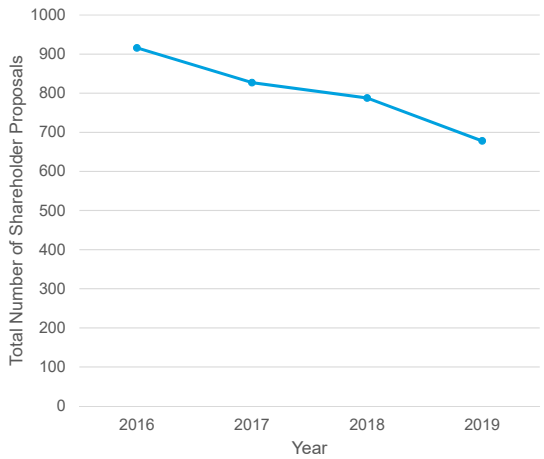
2019 Proxy Season Trends and Developments



Fewer proposals were submitted: Overall, the total number of shareholder proposals submitted continued its downward trend.

Many proposals were withdrawn or excluded: As in prior years, many submitted proposals were not voted on because they were withdrawn following discussions with the company or excluded pursuant to the SEC's no-action letter process.

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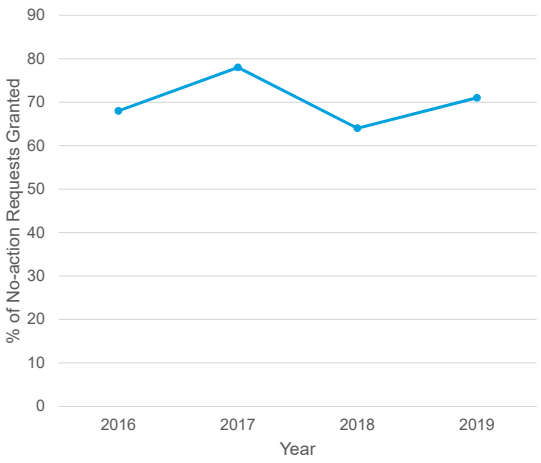
2019 Proxy Season Trends and Developments



A greater percentage of no-action relief was granted vs last year: The Staff granted 71% of the no-action requests submitted during the 2019 proxy season, compared to 64% during the 2018 proxy season.

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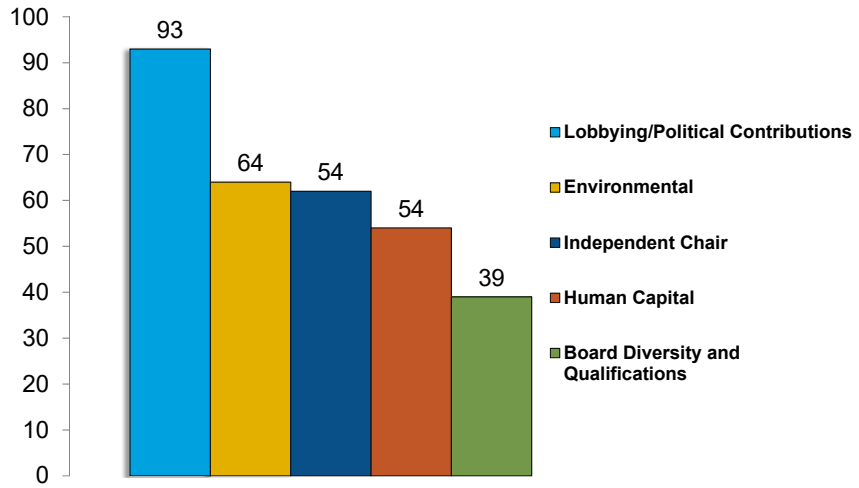
Most Commonly Submitted Proposals



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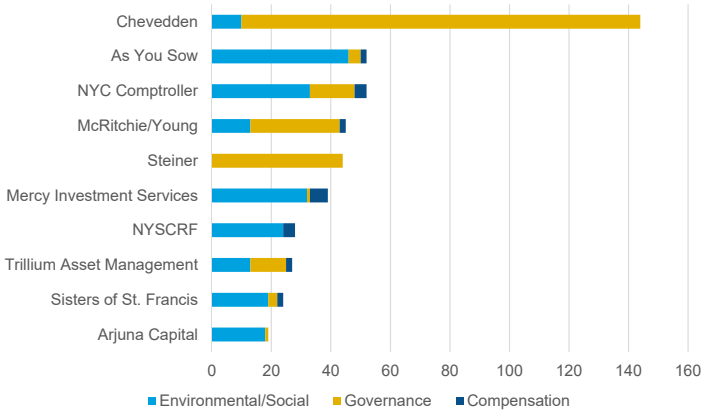
Most Frequent Proponents



The top 10 proponents accounted for more than half of shareholder proposals.

The Chevedden Group (Chevedden, McRitchie, Young, Steiner), historically a corporate governance proponent, announced in late 2018 that it would begin making ES proposals.

In 2019, the Group accounted for nearly a third of all proposals on political spending.

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Environmental and Social Proposals

Submitted: 323 in 2019 proxy season vs 433 in 2018

Approved in 2019 proxy season:

- At least four on lobbying/political contributions disclosure
- At least two on board oversight of opioid manufacturing/distribution
- At least two on workplace diversity reports
- At least one on human rights for inmates and detainees

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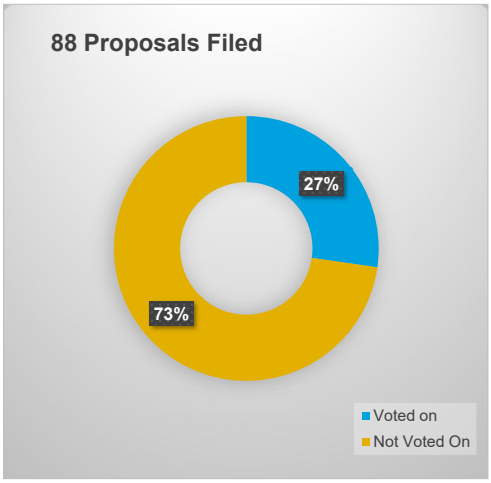
Environmental Proposals



Examples

- Reports on GHG reduction targets and alignment with 2015 Paris Agreement to maintain global temperatures below 2 degrees Celsius
- Phase out of plastic products and packaging
- Report on impact of micro plastics (Nurdles!)
- Issue sustainability reports

Trends

- No-Action Success: As reported by *Inside Climate News*, nearly two-thirds of climate-related proposals filed at energy and utility companies were contested, and by early May, the SEC had granted 45% of no-action requests.
- Vote-No Campaign: NYSCRF waged a vote-no campaign against the Exxon board when its climate change proposal was excluded.
- Declining Average Support: Support averaged 25.6% of votes cast, compared to 32.8% in 2017.
- One proposal passed (BP) compared to five in 2018.

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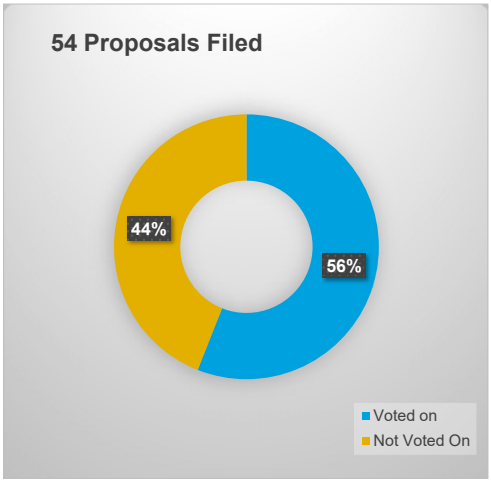
Human Capital Proposals



Examples

- Report on the pay gap between male and female employees and plans to close that gap
- Breakdown of employees by race and gender across job categories, and disclosure of policies and programs for increasing diversity in the workplace
- No mandatory arbitration clauses for discrimination or harassment claims

Trends

- Lower Withdrawal Rates than Environmental: 54 proposals filed and 30 voted on
- Stable Average Support: Support averaged 30.0% of votes cast, compared to 28.2% in 2018.
- Two workplace diversity proposals passed compared to none in 2018.

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Human Rights Proposals

- Report on treatment of people held at correctional facilities and migrant detention centers
- Establishment of an international policy committee to oversee human rights in China
- Report on protecting children from sexual abuse online
- Adoption of a human rights policy to address gun violence

Governance Proposals

Submitted: 359 proposals in 2019 proxy season vs 455 proposals in 2018

Approved:

- At least two on board diversity policies
- At least 16 on abolishing supermajority voting requirements
- At least four on lowering thresholds for shareholders to call special meetings
- At least four on majority voting in uncontested director elections
- At least four on declassifying boards
- At least six on shareholder action by written consent
- At least three on adoption of proxy access

Governance Proposals

- **Increases in:**
  - Independent chair proposals
  - Board diversity and qualifications
  - Abolition of supermajority voting thresholds
- **Declines in:**
  - Special meeting proposals
  - Proxy access proposals
- **Compared to environmental/social proposals, governance proposals are more often excluded than negotiated when they do not come to a vote.**

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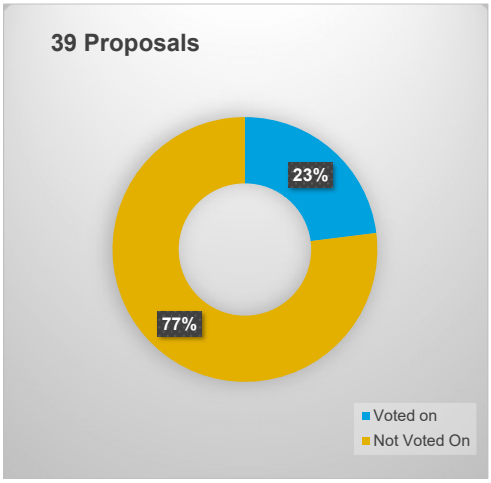
Board Diversity and Qualification Proposals



Examples

- Adoption of a board diversity policy
- Disclosure in matrix form of the minimum qualifications for a director candidate

Trends

- Higher Withdrawal/Exclusion Rates: 39 proposals filed but only nine voted on
- Seven proposals submitted by the Free Enterprise Project, sought to shift the definition of diversity away from race/gender and towards skills, experience and ideological perspectives.
- Decreasing Average Support: Support averaged 8% of votes cast, a decline from 16% of votes cast in 2018; skewed by low-single digit support for Free Enterprise Project proposals
- Two proposals passed compared to none in 2018.

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Executive Compensation Proposals

- **Submitted:** 52 proposals in the 2019 proxy season vs 65 proposals in 2018
- **Approved:** At least two proposals on clawbacks compared to none in 2018
- **Examples:**
  - Alignment of executive incentives with environmental and social Issues:
    - Sustainability metrics
    - Drug pricing strategies
    - Sexual harassment prevention policies
    - Respect for detainee and inmate human rights
  - Disclosure of clawbacks in prior year
  - Amendment of clawback policies to include senior executive misconduct
  - Shareholder approval of severance/termination packages

Expectations for 2020 Proxy Season

Who will be the leading targets?

- Anyone is fair game, but S&P 500 will remain most likely targets
- Big tech
- Fossil fuel companies
- Participants in the plastics, opioid and firearms distribution chains
- Companies with governance provisions that are outside the “mainstream” or their peer group

Expectations for 2020 Proxy Season

Who will be the leading proponents?

- Similar concentrated group of individuals and entities, including the Chevedden Group (Chevedden, McRitchie, Young, Steiner)
- NYC Comptroller's office
- Investor coalitions that submit through individual members
  - National Center for Public Policy Research
  - Interfaith Center on Corporate Responsibility
- Employee activist groups (à la Google, Amazon)
- Special interest coalitions
  - Coalition of 99 investors plan to send letters to 3,000 global companies calling for more transparency on human capital issues

Expectations for 2020 Proxy Season

What will be the major trends in topics?

- Environmental and social issues will continue to be the largest category of proposals
- Continued rise in proposals relating to human capital
- Continued increase in proposals relating to political issues
- Continued decline in governance-related proposals (but strong pass rate)
- Continued decrease in compensation-related proposals
- Small number of anti-ESG proposals

Expectations for 2020 Proxy Season

Environmental proposals

- Fewer proposals on topics related to climate change, especially those with specific targets that can be excluded as “ordinary business/micromanagement”
- More proposals on other environmental issues, including recycling, renewable energy, plastics and sustainability reporting
- Overall, continued decline in number of proposals
- Continued support from shareholders

Political proposals

- Proposals will be focused on disclosure of political contributions and lobbying
- Will be strong due to traction in 2019 and run-up to election year in 2020

Expectations for 2020 Proxy Season

Human capital proposals

- Will continue to rise and cover a wide range of issues:
  - Gender pay equity
  - Workplace diversity
  - Diversity of executive management (Trillium)
  - Sexual harassment
  - More expansive disclosure (*e.g.*, unadjusted global median)
  - Human rights (human trafficking, forced labor in supply chain, illegal immigration detention)
- Trend may be offset as more companies expand disclosure of human capital management

Expectations for 2020 Proxy Season

Governance proposals

Governance proposals will continue to decline as companies remain proactive in adopting governance "best practices"

- Proposals will focus on provisions that are out of the "mainstream"
  - Classified board
  - Plurality voting for directors
  - Supermajority vote thresholds
  - 20% or greater threshold to call a special meeting
  - Dual class shares
- And where market practice has not settled (*e.g.,* independent board chair)

Expectations for 2020 Proxy Season

Proxy access proposals

- Proposals to adopt proxy access bylaws will continue to wane
  - Over 70% of S&P 500 have adopted proxy access bylaws
  - No significant migration downstream to smaller companies
  - Where proposed, likely to be resolved through negotiation or passed
- Proposals to amend proxy access bylaws will decline
  - Most bylaws follow the market standard "3/3/20/20"
  - Where proposed, likely to get ISS support but fail to pass

Expectations for 2020 Proxy Season

Compensation-related proposals

- Will continue to be few in number, continuing the trend post "say-on-pay"
- Focus in executive compensation will be tying compensation targets to social and environmental performance goals
  - Trillium initiative linking diversity performance metrics to senior executive compensation
  - Expect to see other metrics (*e.g.*, cybersecurity and data privacy)
- Focus on workforce equal pay as part of the surge in human capital proposals
- Clawback proposals for companies that experience significant lapse in oversight

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Expectations for 2020 Proxy Season

How will proposals get resolved?

- About 50% will go to a vote, with a small percentage winning majority support
- Many will be withdrawn following negotiation
  - Investors increasingly use shareholder proposals as an invitation for dialogue
  - Companies more willing to reach agreement due to shifts in investor voting
  - Withdrawals will occur both before and after seeking exclusion
- Some will be excluded, based primarily on *substantial implementation* and *ordinary business*
- In rare cases, efforts to exclude may lead to suit or "vote against" campaign
- Shareholders will continue use of exempt solicitation filings to publicize shareholder proposals that are up for vote

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Expectations for 2020 Proxy Season

Negotiated Withdrawals	
Environmental/Social Proposals	Governance Proposals
• In 2019, almost half of environmental and social proposals were withdrawn after engagement with companies • Environmental and social proposals are less binary, allowing more space for negotiation • Companies can make a change that lets the proponents feel they have accomplished more through negotiation than they would through a vote	• Withdrawal rates at historic lows (~13%) • More settled proposals (*annual director elections, majority voting*) have largely been adopted. • Companies know the less settled proposals (*right to act by written consent*) are unlikely to get majority support. • Less appetite for negotiation on either side

Expectations for 2020 Proxy Season

How will the SEC respond to no-action requests?

- In September, the Division of Corporation Finance announced that the Staff may respond orally instead of in writing to some shareholder proposal no-action requests, beginning with the 2019-2020 proxy season.
- Furthermore, the Staff may now more frequently decline to state a view on the no-action request, whereas in the past, it had typically concurred or disagreed with a company's asserted basis for exclusion.
- The Staff still intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8.

Expectations for 2020 Proxy Season

The Role of Proxy Advisory Firms

- Ahead of the 2019 proxy season, the SEC staff withdrew two no action letters that provided comfort to investment advisers in relying on proxy advisory firm recommendations:
  - In *Egan-Jones Proxy Services (May 27, 2004),* the staff had confirmed that by voting based on the recommendations of an independent proxy advisory firm, an investment adviser could "cleanse" its vote, demonstrate the absence of a conflict of interest, and the fulfillment of fiduciary duties.
  - In *Institutional Shareholder Services, Inc. (September 15, 2004),* the staff had confirmed that investment advisers should evaluate the independence of proxy advisory firms based on the facts and circumstances.

Expectations for 2020 Proxy Season

The Role of Proxy Advisory Firms

- In two related releases issued on August 21, 2019, the SEC
  - provided guidance to investment advisors about the steps they should take in order to fulfill their fiduciary duties when they utilize proxy advisory firms (Release Nos. 1A-5325; IC-33605)
  - made it clear that voting recommendations provided by proxy advisory firms are "solicitations" subject to the federal proxy rules, including the antifraud provisions (Release No. 34-86721)
- Response to concern that proxy advisory firms exercise substantial influence over shareholder votes, even though unregulated, may have conflicting interests and may sometimes issue recommendations that contain factual or analytical inaccuracies
- Investment advisors and proxy advisory firms will need to review their policies and practices and may need to make substantial adjustments

Expectations for 2020 Proxy Season

The Role of Proxy Advisory Firms

- Key takeaways from August 2019 SEC guidance
  - Increased transparency and accountability for proxy advisory firms and the investment advisers that rely on them
  - Increased due diligence by investment advisers of proxy advisory firms
  - Disclosure of conflicts of interests by proxy advisory firms
  - Proxy advisors need to substantiate accuracy of information and methodologies used
  - More leverage for issuers to challenge voting recommendations
  - More time and better process to resolve factual or analytical inaccuracies raised by issuers?
  - Some small investment advisers may refrain from voting
  - Limited impact on the voting policies or specific voting recommendations issued by proxy advisory firms or the number investment advisers that follow those policies or recommendations

Expectations for 2020 Proxy Season

Other changes in legal requirements that could impact shareholder proposals under consideration, but unlikely to be adopted prior to 2020 proxy season.

- Further actions by the SEC
  - Rulemaking on proxy advisory firms
  - Minimum thresholds for shareholders to submit and resubmit proposals
  - "Proxy plumbing" reforms
- Pending legislation
  - Regulation of proxy advisory firms
  - Minimum thresholds for shareholders to submit and resubmit proposals

Responding to a Proposal: The Process

1. 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

Responding to a Proposal: The Process

2. Establish key deadlines for responding to the proposal

- (See sample timeline).

3. Confirm the proponent's eligibility and procedural compliance with proxy rules:

- Compliance with ownership and timeliness requirements discussed in the Appendix.
- 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.

Responding to a Proposal: The Process

Submission of proposals through a representative is consistent with Rule 14a-8.

- **In light of concerns about eligibility to submit proposals, the Staff will look for documentation to:**
  - Identify the shareholder proponent and the person or entity selected as proxy;
  - Identify the company to which the proposal is directed;
  - Identify the annual or special meeting for which the proposal is submitted;
  - Identify the specific proposal to be submitted; and
  - Be signed and dated by the shareholder.
- **Not a "new foot fault:"** materials that allow a reasonable conclusion of eligibility are sufficient

Including a Shareholder Proposal

4. 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 five 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))*

Including a Shareholder Proposal

5. Be prepared for exempt solicitations:

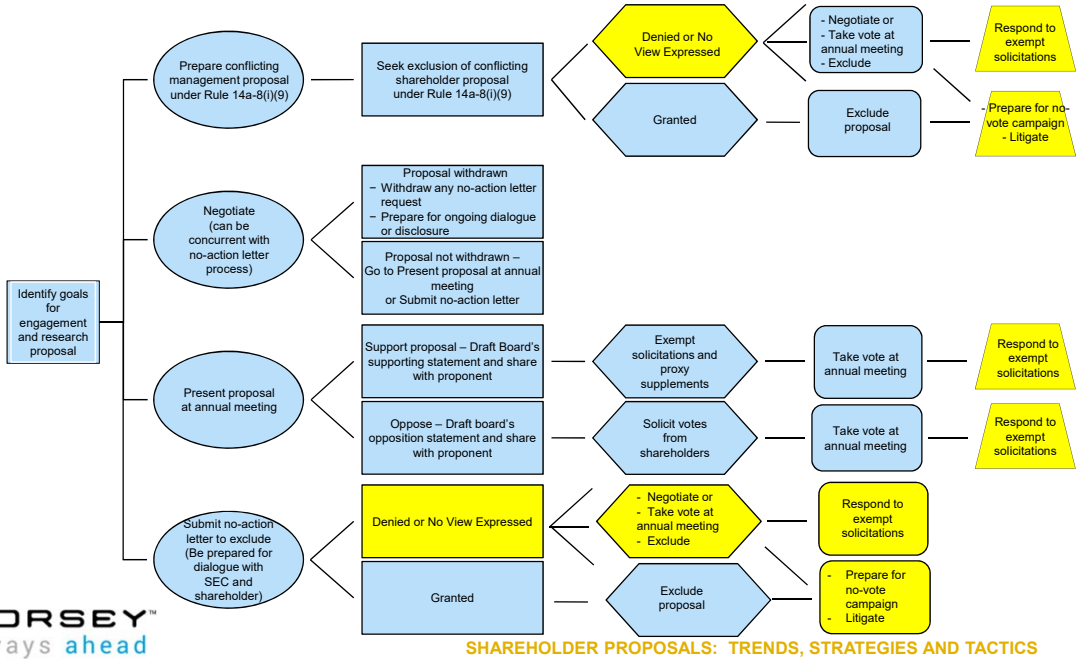
- After a proxy has been filed, proponents are using exempt solicitation filings (PX14A6G filings) to broadcast their response to company opposition statements
- Companies face a decision to respond or not to respond.
- For companies that respond with a communication to shareholders:
  - An amended or supplemental filing is likely required; the SEC has taken the position that even websites, email correspondence and scripts used for oral solicitations may be considered proxy soliciting materials to be filed
  - Post the materials on the same website as the original proxy materials, no later than the day that the supplemental material is first sent or made public
  - Decide what further steps should be taken to disseminate the information to shareholders

Excluding a Shareholder Proposal

6. If the company seeks to exclude the shareholder proposal from its proxy statement:

- 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.

Shareholder Proposal Response Plan



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Excluding a Shareholder Proposal

Beyond shareholder eligibility, there are 13 substantive bases for exclusion under Rule 14a-8. We have summarized the number of no-action requests granted under each basis from October 1, 2018 – Present:

Basis for Exclusion	Requests Granted as Primary Basis	Approx. No. of Times Cited as a Basis	Success Rate
Improper subject for action by shareholders under state law *(Rule 14a-8(i)(1))*	None	2	0%
Violation of law *(Rule 14a-8(i)(2))*	3	10	33%
Violation of proxy rules, ie, materially false or misleading*(Rule 14a-8(i)(3))*	1	42	2%
Relates to a personal grievance or special interest *(Rule 14a-8(i)(4))*	None	4	0%
Insignificant relationship to company's business *(Rule 14a-8(i)(5))*	1	9	11%

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Excluding a Shareholder Proposal

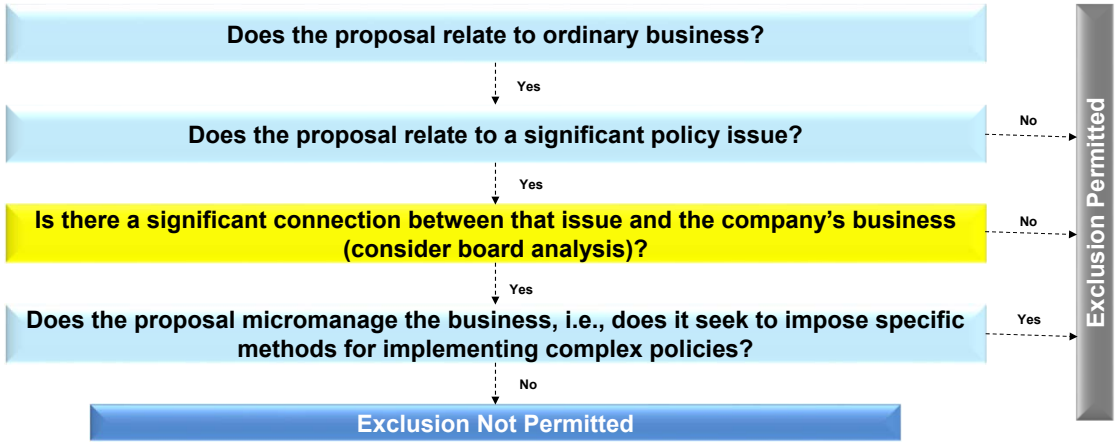
Basis for Exclusion	Requests Granted as Primary Basis	Approx. No. of Times Cited as a Basis	Success Rate
Lack of power or authority of the company to implement the proposal *(Rule 14a-8(i)(6))*	1	10	10%
Ordinary business operations *(Rule 14a-8(i)(7))*	41	101	41%
Affects the outcome of upcoming director election *(Rule 14a-8(i)(8))*	6	7	86%
Conflicts with the company's proposal *(Rule 14a-8(i)(9))*	1	6	17%
Substantial implementation *(Rule 14a-8(i)(10))*	40	81	49%
Substantially duplicates another proposal submitted by another shareholder *(Rule 14a-8(i)(11))*	6	13	46%
Resubmissions of certain prior proposals *(Rule 14a-8(i)(12))*	2	3	67%
Relates to specific amount of dividends *(Rule 14a-8(i)(13))*	1	2	50%

Rule 14a-8(i)(7): Ordinary Business

Permits exclusion of a proposal that "deals with a matter relating the company's ordinary business operations."

- Two basic considerations for evaluating whether an activity is excludable (Exchange Act Release No. 34-40018, May 21,1998)
  - The tasks 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
  - The proposals seek to "micro-manage" the company by "probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."
- Not available for issues that are so significant as to "transcend ordinary business" matters
  - What constitutes a "significant policy issue" is subjective and matter of debate

Rule 14a-8(i)(7): Ordinary Business



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Rule 14a-8(i)(7): Ordinary Business

Ordinary business exclusion granted without board analysis

- Where it is "self-evident" that the proposal topic relates to the company's ordinary business matters, it is not necessary to include a discussion regarding a board's analysis of the proposal's significance
- Certain tasks are so fundamental to management' 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
  - Management of the workforce, such as hiring, promotion and termination employees
  - Decisions on production quality and quantity
  - Retention of suppliers to a company

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Rule 14a-8(i)(7): Ordinary Business

Ordinary business exclusion granted without board analysis

- Examples from the 2019 proxy season:
  - Requesting company offer shareholders discounts on products and services that are available to employees (*Verizon Communications Inc*., January 29, 2019)
  - Requesting face-to-face annual meeting, to replace current remote or virtual meetings (*Frontier Communications Corporation*, February 19, 2019)
  - Requesting board commission an independent study of amendments to company's governance documents to enhance board's fiduciary oversight of matters relating to customer service and satisfaction (*Wells Fargo & Company*, February 27, 2019)
  - Requesting the board to prepare a report to evaluate the risk of discrimination relating to polices and practices for hourly workers taking absence from work for personal or family illnesses (*Walmart Inc.*, April 8, 2019)

Rule 14a-8(i)(7): Ordinary Business

Ordinary business exclusion including a board analysis

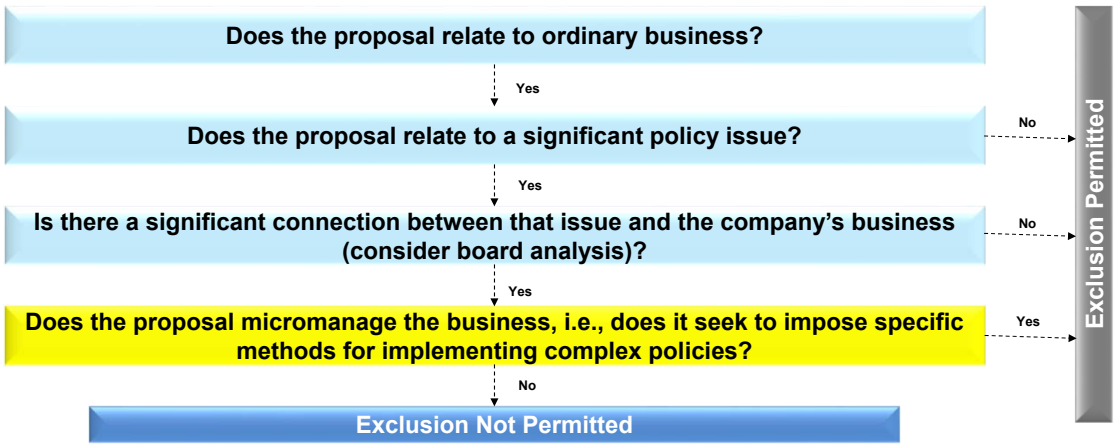
- Guidance from SLB 14I, SLB 14J and no-action letters
  - If the ordinary business matter is not "self evident", a discussion of the board's analysis of the significance of the issue to the company will likely be necessary.
  - Discuss the specific proposal and its application to the company's specific operations, rather than a broad discussion of the general significance of the issue presented.
  - Details may include board meetings and discussions with consultants, although board materials not required to be included.
  - Discuss in detail any specific differences between the action requested by the proposal and the company's current policies, practices, procedures or disclosures and the difference between the proposed actions and the company's current practice.
  - Shareholder engagement demonstrates the board has an informed understanding.
  - If there has been a recent shareholder vote on a similar proposal, discuss the most recent vote and the actions taken by the company following the vote.

Rule 14a-8(i)(7): Ordinary Business

Ordinary business exclusion including a board analysis

- Examples from the 2019 proxy season
  - Allowed to exclude proposal requesting that the Board prepare a report to shareholders that evaluates overdraft policies and practices and the related impact on customers (*Bank of America Corporation*, February 21, 2019)
  - Allowed to exclude proposal that Board adopt a policy prohibiting the company from engaging in certain employment practices (mandatory arbitration of employment-related claims; noncompete agreements, nondisclosure agreements related to settlement of claims relating to discrimination or harassment) (*Yum! Brands, Inc.*, March 6, 2019)
  - Not allowed to exclude proposal requesting that the Board prepare a report to shareholders on the company's efforts to identify and reduce environmental and health hazards relating to handling of coal combustion residuals and related reduction of legal, reputational and financial risks, because it transcends ordinary business matters (*PNM Resources, Inc.*, April 2, 2019)

Rule 14a-8(i)(7): Ordinary Business



Rule 14a-8(i)(7): Ordinary Business

Micromanagement exclusion granted:

- Proposal seeks to impose specific methods for implementing complex policies in place of the ongoing judgments of management as overseen by the Board.
  - Involves intricate detail
  - Seeks to impose specific time frames or methods for implementing complex policies
  - Seeks to impose a specific outcome on the company
- Examples from 2019 proxy season
  - Impose specific targets on greenhouse gas emissions
  - Require specific website statements
  - Require shareholder approval of all stock repurchases
  - Prohibit specific compensation practices

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

Background:

- 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 original rule was "designed to avoid the possibility of shareholders having to consider matters which have already been favorably acted upon by the management," but did not include a concept of "substantial implementation." (*Release No. 34-12598, July 7, 1976)*
- The Commission later adopted a revised interpretation of the rule to permit the omission of proposals that had been "substantially implemented." *(Release No. 34-20091, August 16, 1983 and Release No. 34-40018, n.30, May 21, 1998)*

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

- **Continues to be one of the most used and successful bases for exclusion**, accounting for 39% of all exclusions granted and a 49% success rate in the 2019 proxy season
- **70% of successful requests related to governance proposals.**
- **In granting requests, the staff frequently concludes that:**
  - The company's policies, practices, procedures or public disclosures "compared favorably" to the proposal or
  - The company's board will provide shareholders with an opportunity to approve the proposed changes at the next annual meeting, approved the necessary amendments for submission to a shareholder vote, or the company intends to present those amendments for a shareholder vote at the next annual meeting.

Appendix
Responding to a Proposal: The Basics

Responding to a Proposal: The Basics

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 most state corporation laws, 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).

Responding to a Proposal: The 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.
- Submission thresholds being reconsidered by the SEC.

Responding to a Proposal: The Basics

When must the proposal be submitted?

- For proposals outside of a company's proxy statement, advance notice bylaws typically establish deadlines.
- For proposals included in a company's proxy statement, shareholders must submit the proposal by the deadline disclosed in last year's proxy statement (typically, 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.

Responding to a Proposal: The Basics

Do website addresses count against Rule 14a-8(d)'s 500-word limit on shareholder proposals?

A reference to a website address counts as one word, but the information contained in that website does not count against the word limit. The website may, however, 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)*

Responding to a Proposal: The Basics

Do graphics count against a proposal's word limit?

- Graphics may be included in accordance with Rule 14a-8(d).
- SLB 14I stated that the inclusion of graphs and/or images in proposals outside of the 500-word limit is not prohibited, but words in graphics count towards limit.
- Nevertheless, Rule 14a-8(i)(3) permits exclusion of graphs and/or images where they:
  - make the proposal materially false or misleading;
  - render the proposal so inherently vague or indefinite that neither the stockholders voting on the proposal, nor the company in implementing it, would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires;
  - directly or indirectly impugn character, integrity or personal reputation, or directly or indirectly make charges concerning improper, illegal, or immoral conduct or association, without factual foundation; or
  - are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.

Shareholder Proposal Deadlines					
Action	**Relevant Resources**	**Required Timing**	**Date**	**Responsible Party**	**Complete**
Deadline to receive shareholder proposals for inclusion in proxy statement	Rule 14a-8(e)	120 days prior to Mailing Date			
Deadline to receive shareholder proposals outside of proxy statement	Bylaws				
Send notice of procedural defects to the proponent, if needed	Rule 14a-8(f)(1)	Within 14 days of the date the proposal was received			
Deadline for response to notification of procedural defects	Rule 14a-8(f)(1)	Within 14 days of the date the proponent received the notice			
Draft no-action request and/or competing management proposal		After deadline to cure procedural defects has passed			
Deadline to file no-action request with SEC; simultaneously notify proponent of filing	Rule 14a-8(j)	No later than 80 days prior to filing definitive proxy statement			
If proposal is included in proxy statement:					
Draft statement in opposition to shareholder proposal					
Board meeting - approve statement in opposition, as applicable					
Provide proponent with copy of statement in opposition	Rule 14a-8(m)	No later than 30 calendar days before filing definitive proxy			
Deadline for proponent to submit revised proposal to the Company, if allowed by SEC staff	Division of Corporation Finance Staff Legal Bulletin No. 14 (July 13, 2001) at B.3 and B.12	Within 7 days after the date the proponent receives the staff's response			
If the proponent revises its proposal as required by SEC staff, provide proponent with copy of revised statement in opposition	Rule 14a-8(m)	Within 5 days after receiving the proponent's revised proposal			
Mail definitive proxy to shareholders	Rule 14a-16	No less than 40 days prior to annual meeting, assuming notice and access			

September 17, 2019

Observations and Recommendations on the SEC's Recent Process Changes for Excluding Shareholder Proposals

Cam Hoang

Earlier this month, the SEC's Division of Corporation Finance announced that its staff may respond orally instead of in writing to some shareholder proposal no-action requests, beginning with the 2019-2020 proxy season. Furthermore, the staff may now more frequently decline to state a view on the no-action request, whereas in the past, it had typically concurred or disagreed with a company's asserted basis for exclusion.

As background, companies submit no-action requests in order to exclude shareholder proposals from their annual meeting proxy statements. When these requests are granted under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the staff will not recommend that the SEC take enforcement action in response to the exclusion of a shareholder proposal. Over the last proxy season (since October 1, 2018), more than 230 no-action requests were submitted to the SEC for review. Transitioning to oral responses is intended to make the process more efficient for the staff in light of the large volume of requests. The staff still intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8.

The SEC's announcement lacked a number of important details and leaves much to speculation. It remains to be seen how frequently the staff will issue oral versus written determinations. In remarks before the U.S. Chamber of Commerce in July, Director of the Division of Corporation Finance Bill Hinman had commented that under an updated process, requests based on difficult topics, such as the ordinary business exclusion, would likely continue to receive responses from the staff. In the announcement, the staff reiterates that board analysis is often useful for requests on the basis of the ordinary business or economic relevance exceptions. Whether the staff responds orally or in writing, it will inform the proponent and the company of its position, which may be that the staff concurs, disagrees or declines to state a view, with respect to the company's asserted basis for exclusion.

As discussed below, in light of the revised no-action process, it becomes more important for companies to designate an appropriate and prepared representative to receive the staff's call and to keep a careful record of the discussion. For more discussion on the SEC's announcement, see the Observations and Recommendations below, and register for our upcoming webinar, Shareholder Proposals: Strategies and Tactics.

Observations and Recommendations

There will be more flexibility for staff, but likely less information publicly available. Until now, companies and proponents have been able to review a complete database of the staff's responses, which have all been issued in written form, to discern trends, and to observe consistencies as well as inconsistencies in the determinations. Under the updated process, it is not clear whether the staff will provides public access to its oral responses. SEC Rule 81 only provides for public access to the staff's *written* communications in connection with no-action requests, as soon as practicable after the response has been sent or given. If their oral responses are not made public, and if they have more flexibility to decline to state a view, the staff will also have more latitude to make case-by-case determinations under less scrutiny.

Faster responses to no-action requests? In keeping with the staff's commitment to a more efficient process, oral versus written responses may facilitate more prompt turnaround on no-action requests, though the staff has made no such commitment.

The staff likely will not provide information in calls beyond what is stipulated in the announcement. In each case, the staff will communicate their determination with respect to the asserted basis for exclusion, to both the company and the proponent. However, we do not expect additional substantive information to be communicated verbally. The staff will avoid conflicting messages, or unnecessarily prejudicing either party, for example, by providing one party with more detail or nuance than has been received by the other party. Furthermore, the staff is unlikely to entertain additional requests, such as requests for reconsideration, on a call. This approach would be aligned with the spirit of previous guidance. In SLB 14B, the staff stated that "In order to ensure that the staff's process is fair to all parties, we base our determinations on the written materials provided to us. While we will respond to telephone questions from the company or the shareholder proponent regarding the status of a request, we do not discuss the substantive nature of any specific no-action request with either the company or the shareholder proponent. Therefore, we request that any additional information that the company or the shareholder proponent would like to provide be submitted to us and the other party in writing."

Written no-action letters may contain more guidance, and they will receive more scrutiny. Currently, the staff will often issue a determination with little or no explanation for why they concur or disagree with the bases cited in the no-action request. Since the staff has now specified that written letters will now be issued where they may provide "broadly applicable guidance," we expect that the letters will contain more substantive guidance than they have in the past.

Companies will need to carefully assess alternatives if the staff declines to state a view on any particular request. Negotiated withdrawals may become even more attractive. The announcement confirms that if the staff declines to state a view on any particular request, the interested parties should not interpret that position as indicating that the proposal must be included. In such circumstances, the staff is not taking a position on the merits of the arguments made, and the company may have a valid legal basis to exclude the proposal under Rule 14a-8. As an alternative, the parties may seek formal, binding adjudication on the merits of the issue in court—an option that has always been available but rarely pursued.

It is unclear how frequently the staff will decline to take a view on a no-action request. There are certain bases for exclusion that may more readily invite this position. For example, where companies cite a violation of law as a basis for exclusion under Rule 14a-8(i)(2), the staff may be more likely to defer to rulings by courts, the SEC or other state or federal authorities, as the staff largely did in their response to Johnson & Johnson regarding a proposal for the adoption of mandatory arbitration bylaws, discussed here.

Without a definitive staff determination, and faced with the unappealing prospect of litigation, parties may accelerate the already existing trend towards negotiated withdrawals on a broad range of shareholder proposals. In the absence of a withdrawal, the company still has the option either to exclude the proposal without a staff concurrence, which carries some risk of potential litigation, or present it for a shareholder vote.

Will companies exclude shareholder proposals without staff concurrence? Some commentators posit that the staff's refusal to state a view will provide companies with more latitude to exclude proposals, but it appears that investor and proxy advisory firm pressure will discourage companies from unilaterally excluding proposals. While it is the exception rather than the rule that proponents have resorted to litigation in the past to challenge the exclusion of a shareholder proposal, coalitions of investors are finding that the influence and the resources to do so in order to pressure companies into settlement. Furthermore, institutional investors and proxy advisory firms may take a dim view of a company's unilateral determination to exclude a proposal. Under their existing voting policies, ISS and Glass Lewis may recommend votes against directors of companies that exclude proposals without a no-action determination or court order, though these policies may be modified in light of the staff's expanded ability to decline to state a view.

Will there be more shareholder proposals submitted and voted on? The staff's potential refusal to take a view creates greater uncertainty around the no-action process. The absence of a complete written record of the staff's position on no-action letter request during a proxy season will make it more difficult to assess the probability of success going forward. This lack of transparency may deter companies from making requests, particularly where they are not confident that there is a firm basis for exclusion. As a result, the announcement may encourage a greater number and a greater variety of shareholder proposals to be submitted, and once submitted, to be voted on instead of excluded.

Designate an appropriate and prepared representative and keep a record on conversations with the staff. In light of the revised no-action process, companies should designate an appropriate and prepared representative to receive the staff's calls. This representative should be an individual who is generally familiar with the no-action process and with the specific request at issue, such as the general counsel, the corporate secretary or outside counsel. If the staff does not concur with the company's position, the company likely will not be able to make requests on the call, but will continue to be able to make subsequent, written requests for reconsideration. The representative should be provided with guidelines for conducting the call and asking appropriate questions in order to obtain as much clarity as possible. The company should also create a record of its written and oral communications with the staff. The record will provide a basis for a report to the board and the company's decision-makers with regard to current and future shareholder proposals.

August 26, 2019

SEC Adopts Guidance Impacting Voting Recommendations from Proxy Advisory Firms

Gary Tygesson

In two related releases issued on August 21, the SEC updated its guidance and interpretations to heighten the scrutiny given to the voting recommendations made by proxy advisory firms such as Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. and the investment advisors that rely on those recommendations. In the **first release**[1], the SEC provided guidance to investment advisors about the steps they should take in order to fulfill their fiduciary duties when they utilize proxy advisory firms. In the **second release**[2], the SEC made it clear that voting recommendations provided by proxy advisory firms are "solicitations" subject to the federal proxy rules, including the antifraud provisions.

In recent years, the use of proxy advisory firms by investment advisors and other institutional investors has become more widespread and the services offered by such firms have expanded. The SEC's guidance was adopted in response to concerns that proxy advisory firms exercise substantial influence over shareholder votes even though they are unregulated, may have conflicting interests and may sometimes issue recommendations that contain factual inaccuracies.

The guidance is effective immediately, just in time to play an important role in the upcoming proxy season. Investment advisors and proxy advisory firms will need to review their policies and practices and may need to make substantial adjustments, especially in light of the relatively short period of time between the availability of a company's proxy statement and the date of the related shareholder meeting.

Guidance for Investment Advisors that Utilize Proxy Advisory Firms

An investment advisor and its client can agree on the scope of the advisor's voting authority through full and fair disclosure and informed consent. An investment advisor that assumes proxy voting authority must make voting determinations consistent with its fiduciary duties and in compliance with Rule 206(4)-6 under the Investment Advisers Act of 1940, which includes the need for the investment advisor to conduct a reasonable investigation into matters on which the advisor votes and to vote in the best interest of the client.

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1 Available at https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

2 Available at https://www.sec.gov/rules/interp/2019/34-86721.pdf.

When making voting determinations on behalf of clients, many investment advisors retain proxy advisory firms to perform a variety of functions and services. In the August 21 guidance, the SEC warned investment managers about outsourcing their voting responsibilities to proxy advisory firms and set forth a number of recommendations for satisfying their principles-based fiduciary duties when they retain a proxy advisory firm to assist them in some aspect of their proxy voting responsibilities.

When an investment advisor is considering whether to retain or continue retaining a proxy advisory firm to provide research or voting recommendations as an input to the advisor's voting decisions, they should consider, among other things:

- whether the proxy advisory firm has the capacity and competency to adequately analyze the matters for which the investment advisor is responsible for voting;
- the adequacy and quality of the proxy advisory firm's staffing, personnel and technology;
- whether the proxy advisory firm has an effective process for seeking timely input from issuers and proxy advisory firm clients with respect to, for example, its proxy voting policies, methodologies and peer group constructions, including for "say-on-pay" votes;
- how the proxy advisory firm, in constructing peer groups, takes into account the unique characteristics of the issuer, such as the issuer's size, its governance structure, its industry and any particular practices unique to that industry, its history and its financial performance;
- whether a proxy advisory firm has adequately disclosed to the investment advisor its methodologies in formulating voting recommendations, so that the investment advisor can understand the factors underlying the proxy advisory firm's voting recommendations;
- the nature of any third-party information sources that the proxy advisory firm uses as a basis for its voting recommendations; and
- the steps it should take to develop a reasonable understanding of when and how the proxy advisory firm would expect to engage with issuers and third parties.

An investment advisor should also consider the effectiveness of the proxy advisory firm's policies and procedures for obtaining current and accurate information relevant to matters included in its research and on which it makes voting recommendations. As part of this assessment, investment advisors should consider, and in certain cases may wish to communicate with proxy advisory firms, about the firm's

- engagement with issuers, including the firm's process for ensuring that it has complete and accurate information about the issuer and each particular matter, and the firm's process, if any, for investment advisors to access the issuer's views about the firm's voting recommendations in a timely and efficient manner;
- efforts to correct any identified material deficiencies in the proxy advisory firm's analysis;

- disclosure to the investment advisor regarding the sources of information and methodologies used in formulating voting recommendations or executing voting instructions; and
- consideration of factors unique to a specific issuer or proposal when evaluating a matter subject to a shareholder vote.

Guidance is also included regarding the steps an investment advisor should consider taking when it becomes aware of potential factual errors, incompleteness or methodological weaknesses in the proxy advisory firm's analysis that may materially affect one or more of the investment advisor's voting determinations.

An investment advisor that retains a proxy advisory firm to provide voting recommendations or voting execution services should consider additional steps to evaluate whether the investment advisor's voting determinations are consistent with its voting policies and procedures and in the client's best interest before the votes are cast. Examples of some steps that an investment advisor could use to evaluate its compliance include:

- sampling "pre-populated" votes shown on the proxy advisory firm's electronic voting platform before such votes are cast;
- considering additional information that may become available regarding a particular proposal, such as additional proxy soliciting materials or other information conveyed by an issuer or shareholder proponent to the investment advisor; and
- considering whether a higher degree of analysis may be necessary or appropriate to assess whether any votes it casts on behalf of its client are cast in the client's best interest, such as in merger transactions or contested elections.

Proxy Advisory Firm Voting Recommendations Are Subject to Proxy Rules

The SEC also updated its guidance and interpretations to provide that proxy voting advice generally constitutes a "solicitation" under the federal proxy rules and, while it may be exempt from the information and filing requirements of the Securities Exchange Act of 1934, it is subject to the antifraud provisions of Rule 14a-9 under the Exchange Act.

The SEC stated that the definition of "solicitation" is broad and includes, among other things, a "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy," even where the person is not seeking authorization to act as a proxy or is indifferent to the outcome of the matter being voted on. The SEC noted that proxy advisory firms typically provide their voting recommendations to their clients shortly before a shareholder meeting with the expectation that those recommendations will be used by their clients when making their voting decisions. Therefore, the SEC concluded that voting advice provided by a firm marketing its expertise in researching and analyzing proxy issues for purposes of helping its clients make proxy voting determinations (not merely performing administrative or ministerial services) should be considered a solicitation subject to the federal proxy rules, even if the proxy advisory firm is providing recommendations based on its application of the client's own tailored voting guidelines.

While the SEC made it clear that proxy voting advice may be exempt from the information and filing requirements of the federal proxy rules, even exempt solicitations remain subject to the antifraud provisions of the Exchange Act. Specifically, Rule 14a-9 prohibits any solicitation from containing any statement which is false or misleading with respect to any material fact, or omitting to state any material fact necessary in order to make the statements therein not false or misleading. Rule 14a-9 also extends to opinions, reasons, recommendations or beliefs that are disclosed as part of a solicitation. Where such opinions, recommendations or similar views are provided, disclosure of the underlying facts, assumptions, limitations and other information may be needed so that these views do not raise Rule 14a-9 concerns.

The SEC recommends that the provider of the proxy voting advice should consider whether, depending on the particular statement, it may need to disclose the following types of information in order to avoid a potential violation of Rule 14a-9:

- an explanation of the methodology used to formulate its voting advice on a particular matter (including any material deviations from the provider's publicly-announced guidelines, policies or standard methodologies for analyzing such matters) where the omission of such information would render the voting advice materially false or misleading;
- to the extent that the proxy voting advice is based on information other than a company's public disclosures such as third-party information sources, disclosure about these information sources and the extent to which the information from these sources differs from the public disclosures provided by the company, if such differences are material and the failure to disclose the differences would render the voting advice false or misleading; and
- disclosure about material conflicts of interest that arise in connection with providing the proxy voting advice in reasonably sufficient detail so that the client can assess the relevance of those conflicts.

By issuing this recent guidance, the SEC is moving ahead on its agenda to address proxy reform issues, this time through Commission-level interpretations of principles that are already part of the existing regulatory framework. In these two releases, the SEC is seeking to increase the transparency and accountability of proxy advisory firms and thereby level the shareholder voting playing field. We can expect further action by the SEC as it continues to consider other proxy reforms, including the submission threshold rules for shareholder proposals and various "proxy plumbing" initiatives.