



Shareholder Proposals: Trends, Strategies and Tactics

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Introduction



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SHAREHOLDER PROPOSALS: TRENDS, STRATEGIES AND TACTICS

Overview

- **2017 Proxy Season Trends and Developments**
- **Expectations for 2018 Proxy Season**
- **Responding to a Shareholder Proposal**
 - Shareholder Proposal Basics
 - Process for Developing a Response
- **Process for Including a Shareholder Proposal**
- **Bases and Process for Excluding a Shareholder Proposal**



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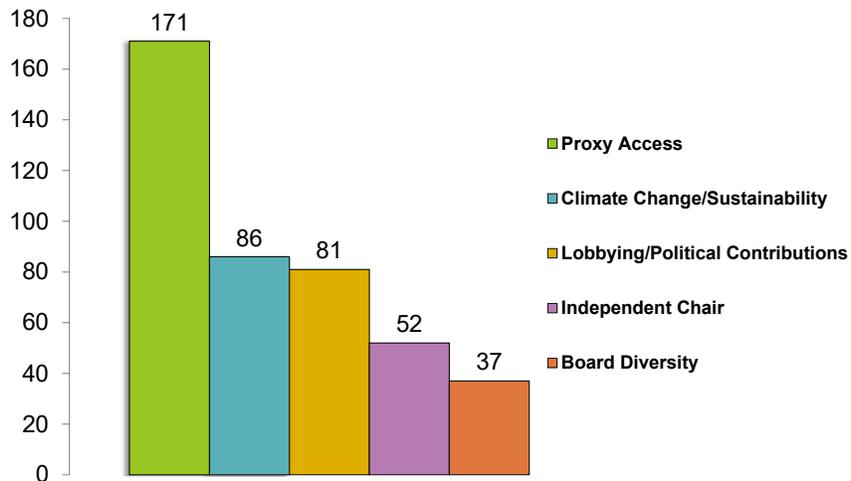
2017 Proxy Season Trends and Developments

- **Fewer proposals submitted:** Overall, the total number of shareholder proposals submitted (827) was down significantly from 2016 (916) and the all-time high in 2015 (943).
- **Shareholder proposals receiving at least 30% average votes cast in favor:** proxy access, climate risk reporting, greenhouse gas emissions reduction, independent chair, board diversity, board declassification, limit golden parachutes, executive stock retention, elimination of supermajority voting, shareholder written consent, right to call special meetings, and majority voting for directors.
- **Many proposals withdrawn:** As in prior years, many submitted proposals were not voted on because they were withdrawn following discussions with the company (25%) or excluded pursuant to the SEC's no-action letter process.
- **More no-action relief granted:** The Staff granted 189 (78%) of the no-action requests submitted during the 2017 proxy season, compared to 143 (68%) requests granted during the 2016 proxy season.



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Most Commonly Submitted Proposals



2017 Proxy Season Trends and Developments

Substantial decline in proposals to adopt proxy access bylaws from 216 in 2016 to 171 in 2017.

- Many companies had already adopted proxy access proposals prior to the 2017 proxy season.
- 175 companies that received proxy access proposals in 2017 reacted by adopting a bylaw, most with terms consistent with market practice (3/3/20/20).
- Terms continue to converge – for example, Fidelity now supports market practice, except it still supports a 5% ownership threshold for small cap companies.
- 28 resolutions came to a vote, with higher support level (58%) and pass rate (64%) than in 2016.

2017 Proxy Season Trends and Developments

Big increase in voted proxy access bylaw “fix-it” proposals from 8 in 2016 to 22 voted on in 2017

- Proposed one or more amendments to existing bylaws, including:
 - Changing aggregation limit from 20 to 40/50 shareholders
 - Increasing proxy access nominees from 20% to 25% of board
 - Removing renomination limits
- Many proposals successfully excluded based on substantial implementation
- No proposals received majority support, averaging 28.1% of votes cast



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2017 Proxy Season Trends and Developments

Excluding proxy access, there was a decline in other governance proposals from 493 in 2016 to 409 in 2017.

- **Such proposals covered topics that averaged majority support:**
 - Declassifying board terms
 - Adopting majority voting in uncontested director elections
 - Eliminating supermajority voting provisions
- **As well as topics that averaged less than majority support:**
 - Independent chair
 - Allowing written consent of shareholders
 - Adopting special meeting rights
- **Many companies, especially larger companies, have already implemented changes in response to prior shareholder proposals, shareholder engagement or otherwise.**



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2017 Proxy Season Trends and Developments

Watershed year for environmental and social (E&S) proposals.

- E&S was the only proposal category that had a spike in filings (345 proposals)
- **Environmental/climate change proposals**
 - Dealing primarily with the business impact of the Paris Agreement’s 2 degree Celsius limit on global warming
 - Support surged to 45% from 38% last year
 - Passed at Exxon Mobil, Occidental and PPL
 - Significant new support from major institutional investors (BlackRock, State Street, Vanguard, Fidelity)
- **Board diversity proposals**
 - Record 37 resolutions filed; 60% withdrawn following negotiations
 - Average support rose to 28% from 25% in 2016; passed at 2 companies
 - Significant new support for proposals from major institutional investors (BlackRock, State Street) that also voted against members of the nominating committees at some companies with all-male boards



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2017 Proxy Season Trends and Developments

- **Workforce diversity proposals**
 - Number of filed proposals doubled to 17
 - Typically request a breakdown of employees by race and gender across job categories, and disclosure of policies and programs for increasing diversity in the workplace
 - Half of the resolutions withdrawn following agreements to publicize workforce diversity data
 - Support for resolutions that came to a vote increased to 29%, the highest level since 2012
- **Gender pay equity proposals**
 - 19 proposals focused on the gender pay gap (up from 13 in 2016)
 - Typically request a report on the pay gap between male and female employees and plans to close that gap
 - Half of the resolutions withdrawn following agreements
 - Eight proposals voted on did not reach 20% support
 - Expanded beyond tech companies to include financial services and consumer companies



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2017 Proxy Season Trends and Developments

Compensation

- Near elimination of executive compensation-related proposals, continuing the trend that began following say-on-pay votes.
- Continued strong say-on-pay support levels with highest average support (over 90%) and lowest failure rate (1%) since SOP first introduced in 2011.
- Move toward annual say-on-pay votes, with most companies and their investors opting for annual votes (95% of S&P 500 companies in 2017).
- Shareholders supported equity compensation plans, with very few companies failing to get shareholder approval and overall support levels averaging around 90%.
- Gender pay equity and CEO/worker pay disparity were the only compensation proposals whose frequency trended upwards.



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Expectations for 2018 Proxy Season

Increased investor focus will continue on:

- Environmental and sustainability issues
- Cybersecurity
- Board diversity, with more proposals, increased shareholder engagement and votes against nominating committee members and
- Workplace diversity and other issues of “human capital” that are tied to long-term growth in shareholder value

Proposals relating to governance, political and lobbying activities and executive compensation will likely continue at similar levels experienced in 2017, with similarly low success rates.



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Expectations for 2018 Proxy Season

Environmental and Sustainability Issues

State Street, Blackrock, Vanguard, Fidelity and UBS have publicly announced changes in their voting policies that result in greater support for climate change resolutions.

- BlackRock and State Street: climate risk is a focus for company engagement.
- Fidelity may support shareholder proposals calling for reports on sustainability, renewable energy and environmental impact issues.
- UBS now votes for a “large majority” of proposals requesting CO₂ emissions reports, explaining climate change risk to investors, or explaining what initiatives they are taking for a 2-degree global warming scenario.



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Expectations for 2018 Proxy Season

Cybersecurity

- Expect more proposals requesting reports on how the board is overseeing privacy and data security
- “I am not comfortable that the American investing public understands the substantial risk that we face systemically from cyber issues and I would like to see better disclosure around that.” SEC Chair Jay Clayton
- SEC staff guidance on cybersecurity discusses, among other things, considerations relevant to a company's risk factors, MD&A, description of business, discussion of legal proceedings, financial statements, and disclosure controls and procedures. *SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 2—Cybersecurity (Oct. 31, 2011)*



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Expectations for 2018 Proxy Season

Board Diversity

- NYC Comptroller Boardroom Accountability Project 2.0
 - 151 companies targeted, 80% are in S&P 500
 - Provides model board matrix disclosure recommended by certain business groups
 - Includes fields for skills and experience and demographic background, such as age, race, ethnicity, gender and sexual orientation
- 18.4% of Equilar 500 and 7.7% of Russell 3000 included a skills matrix in their 2017 proxy statements
 - 45.1% disclosed board composition by gender
 - 39.8% disclosed board composition by race or ethnicity



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Expectations for 2018 Proxy Season

Continued decline in proxy access proposals:

- **Proposal to adopt proxy access bylaws will trickle down to mid- and small-cap companies.**
 - Over 60% of S&P 500 have adopted proxy access bylaws
 - Most follow the market standard “3/3/20/20”
- **Proposals to amend proxy access bylaw provisions will continue:**
 - Provisions that vary significantly from the market standard at greater risk
 - Exclusion based on substantial implementation possible
 - Continue to monitor no-action letters and grounds for excluding new proposal variations



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Expectations for 2018 Proxy Season

Change in legal requirements for shareholder proposals under consideration, but unlikely to be adopted prior to 2018 proxy season.

- Financial CHOICE Act 2.0 adopted by the House would increase share ownership thresholds for submitting shareholder proposals (1% of outstanding for 3 years), increase resubmission thresholds and prohibit proposals by a proxy other than a shareholder.
- Treasury's *Second Report On The Administration's Core Principles Of Financial Regulation* recommends substantially revising the share ownership threshold (for example, by considering the shareholder's dollar holding in company stock as a percentage of his or her net liquid assets) and substantially revising shareholder proposal resubmission thresholds

Universal proxy card put on back burner.

- SEC's proposed rules for adoption of universal proxy card have been reclassified as "long-term" under Chairman Clayton.
- Financial CHOICE Act 2.0 would prohibit SEC from mandating a universal proxy.

How will investors and activists react to Trump administration initiatives to pare back regulation?



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Expectations for 2018 Proxy Season

ISS Governance Principles Survey focus:

- Multi-class share voting structures
- Board gender diversity
- Shareholder authorization for share issuances and repurchases
- Virtual and hybrid shareholder meetings
- Pay ratio disclosure

Proxy voting guidelines are issued in December



SHAREHOLDER PROPOSALS: TRENDS, STRATEGIES AND TACTICS

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).



SHAREHOLDER PROPOSALS: TRENDS, STRATEGIES AND TACTICS

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.
 - Eligibility requirements would change if Financial CHOICE Act 2.0 is adopted.



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Responding to a Proposal: The Basics

- **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.

Responding to a Proposal: The Basics

- **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?**

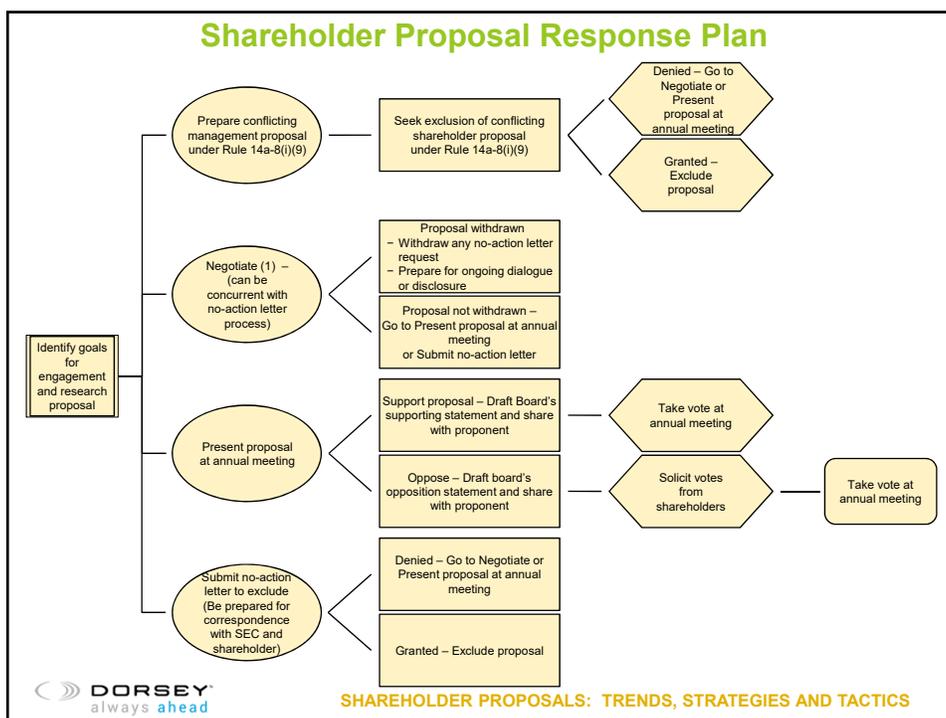
No, shareholders are entitled to use graphics without having them applied against the 500-word limit, but the Staff of the SEC's Division of Corporation Finance (the "Staff") will look at graphics on a case by case basis, and may prohibit them on the basis that they are false and misleading, irrelevant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

Responding to a Proposal: The Process

- **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.

Responding to a Proposal: The Process

- **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
- **Factors to consider**
 - Alignment of proposal with current and future company policies
 - Treatment of similar proposals at peer companies
 - Investor and other stakeholder positions
 - Relationship with proponent(s)
 - Likelihood of future proposals



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))*

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DORSEY always ahead

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.

Excluding a Shareholder Proposal

- **Staff requests (*Staff's June 2017 Rule 14a-8 Stakeholder Meeting*):**
 - Keep us apprised of developments following no-action request.
 - Do not attach copy of Rule 14a-8 or SLBs if a copy of the deficiency notice is included with the no-action request.
 - If proposal included in proxy, describe it accurately (C&DI 301.01/Rule 14a-4).

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.

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)*)
 - Affects the outcome of upcoming 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

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

There are two frequently cited considerations for evaluating whether an activity is within the ken of “ordinary business”:

- Whether 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
- Whether 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.”

Excluding a Shareholder Proposal

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

When would a shareholder proposal be excluded because it “micromanages” a business?

- On January 6, 2017, the SEC Staff granted no-action relief that would allow companies to exclude shareholder proposals preventing management or the board from accessing preliminary voting results on uncontested matters prior to the annual meeting, including a running tally of votes for and against, and using that information to solicit votes. [The Boeing Company](#), [Ferro Corporation](#), [Honeywell International Inc.](#), [L-3 Communications Holdings, Inc.](#), [NiSource Inc.](#), and [Praxair, Inc.](#)
- The Staff concluded that each proposal “relates to the monitoring of preliminary voting results with respect to matters that may relate to [the company’s] ordinary business.”
- Subsequently, the Staff refused to grant no-action relief on a proposal limited to management’s and the board’s access and use of the outcome of votes cast by proxy on certain executive pay matters. [Alexion Pharmaceuticals, Inc.](#) (March 15, 2017)

Excluding a Shareholder Proposal

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**
 - Environmental and social proposals, including political spending, sustainability reporting, and diversity and non-discrimination proposals.
 - Cannot be excluded: 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)*
 - Can be excluded: Proposal requesting that companies generate a plan to reach a net-zero GHG emission status by the year 2030 constitutes micromanagement. *Apple Inc. and Deere & Company (December 5, 2016)*



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Excluding a Shareholder Proposal

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

Courts and the SEC may disagree...

- The Third Circuit presented a 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. *Trinity Wall Street v. Wal-Mart Stores, Inc. (3d Cir. 2015)*
- SEC Staff subsequently confirms its one-step approach whereby significant social policy issues by definition transcend ordinary business and therefore are not excludable. *Staff Legal Bulletin 14H (October 22, 2015)*
- 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.



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Excluding a Shareholder Proposal

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.”
- The Staff’s narrow approach under SLB 14H (October 22, 2015) 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).

Excluding a Shareholder Proposal

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 is still possible to craft management proposals that intentionally directly conflicts with shareholder proposals.

Excluding a Shareholder Proposal

Examples of proposals that may not be excluded:

Proxy Access

- 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
- 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

Compensation

- A shareholder proposal asking the compensation committee to implement a policy that equity awards would have no less than four-year annual vesting
- A management proposal to approve an incentive plan that gives the compensation committee discretion to set the vesting provisions for equity awards



SHAREHOLDER PROPOSALS: TRENDS, STRATEGIES AND TACTICS

Excluding a Shareholder Proposal

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)



SHAREHOLDER PROPOSALS: TRENDS, STRATEGIES AND TACTICS

Excluding a Shareholder Proposal

Substantial Implementation and Proxy Access

- Staff issued a series of no-action letters in early 2016 allowing companies to exclude proxy access proposals if they had adopted proxy access bylaws that fulfilled the “essential objective” of the shareholder proposal.
- In 2017, many “fix-it” proposals were successfully excluded based on substantial implementation.
 - Proposals for multiple revisions: The companies adopted a portion of the proposed changes, especially reducing ownership thresholds from 5% to 3%.
 - Proposals for one revision: The companies provided specific data on both duration and size of holdings in their shareholder base, to demonstrate that proposed changes would not significantly increase the availability of proxy access. See *UHG (Feb. 10, 2017)*