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SEC's September 2020 Rule Toughens Resubmission of Shareholder Proposals

At a publicly traded company's annual or special meeting, its shareholders typically vote to appoint board members and adopt or reject various shareholder- and management-sponsored business proposals, including executive compensation and corporate mergers. Most generally require board adoption to be implemented. Some sources report that there were 858 shareholder proposals in 2020.

In 2020, the SEC adopted controversial rules that would toughen the criteria for resubmitting similar unadopted proposals at subsequent meetings. The rules have sparked opposition, including from some Members of Congress.

Background

State-based business incorporation laws (such as those in the dominant business incorporation state of Delaware) give the states substantial authority over companies that are incorporated within a given state. Under these laws, shareholders of publicly traded companies generally have the right to vote their shares to elect directors, approve or reject a company's generally binding management proposals, and submit and vote on the generally non-binding shareholder proposals.

Within the parameters of the state business incorporation laws, the Securities and Exchange Commission (SEC) oversees the types of information shareholder proposals contain and how that information is disseminated under Rule 14a-8. After a shareholder submits a proposal, the proposal faces three potential outcomes: (1) the corporation may allow it to appear on the ballot for a shareholder vote, (2) the proponent may withdraw the proposal after negotiation with the company, or (3) the company may omit the proposal from the ballot after receiving a no-action letter from the SEC. While the majority of shareholder proposals are non-binding, proposals with the best chance of adoption by a firm's board of directors generally garner a majority of votes.

Public companies are largely owned by institutional investors such as mutual funds and pension funds. However, small investors, including individuals and faith-based groups (sometimes referred to as "gadflies"), have historically played disproportionately large roles as submitters of shareholder proposals. According to one analysis (Nili and Kastiel, 2019), a small group of five individuals accounted for close to 40% of all shareholder proposals submitted to S&P 1500 firms in 2018.

Until recently, activist individual investors' proposals tended toward corporate governance proposals involving corporate board structures and shareholder rights. In recent years, such activist small shareholders have joined pension funds and faith-based investment groups in proposing a panoply of often controversial environmental, social, and governance (collectively, ESG) proposals. Among them are resolutions that have included disclosing political spending, climate-change-related disclosures, employee and board diversity, and disclosures on worker and human rights policies. The 2021 proxy season reportedly set new records with at least 467 shareholder resolutions on ESG issues.

History of the Resubmission Thresholds

In 1948, the SEC amended Rule 14a-8 by prohibiting a shareholder proposal from being included in a proxy statement for shareholder vote if a similar proposal received less than 3% of the votes cast at the previous annual meeting. The agency argued that amendment's goal was "to relieve the management of the necessity of including proposals which have been previously submitted to security holders without evoking any substantial security holder interest therein."

In 1954, arguing that the ability to resubmit proposals that received 3% or more of the vote "resulted in the repetition year after year of proposals which have evoked very modest stockholder interest," the agency amended Rule 14a-8 by allowing two other resubmission thresholds. The amendment allowed firms to also exclude substantially the same subject matter as another proposal or proposals that have been previously included in the company's proxy materials within the preceding five calendar years if the matter was voted on at least once in the last three years and did not receive at least:

- 3% of the vote if previously voted on once,
- 6% of the vote if previously voted on twice, or
- 10% of the vote if previously voted on three or more times.

In 1997, the SEC proposed increasing the resubmission thresholds from 3%, 6%, and 10% to 6%, 15%, and 30%, respectively. It argued that the prevailing thresholds needed to be more stringent, as "a proposal that has not achieved these levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval." Later, citing investor concerns, the SEC opted not to adopt the proposal.

Rule 14a-8 Rulemaking, Support, and Opposition

In September 2020, the SEC commissioners voted 3-2 to amend Rule 14a-8. Principally, the reform will tighten the eligibility criteria needed for investors in publicly traded companies to resubmit proposals. (A corollary reform will impose more rigorous eligibility standards for shareholders who want to submit a proposal. See CRS In Focus IF11883, *The SEC's September 2020 Reform on Investor Eligibility to Advance Shareholder Proposals*, by Gary Shorter.) The reform applies to proposals submitted to annual or special meetings on or after January 1, 2022.

Under the reform, a shareholder's proposal will be excludable from a company's proxy materials if it addressed substantially the same subject matter as a proposal or proposals previously included in the company's proxy materials within the preceding five calendar years if the matter was voted on at least once in the last three years and did not receive at least:

- 5% of the votes cast if previously voted on once;
- 15% of the votes cast if previously voted on twice; or
- 25% of the votes cast if previously voted on three or more times.

Proponents of the revision say it will reduce the number of frivolous proposals and their corporate (and thus ultimately shareholder) costs. It is largely supported by business interests, including the National Association of Manufacturers, the U.S. Chamber of Commerce (a national business trade group), and the Business Roundtable (an association of public company chief executive officers).

Opponents noted that proposals often require repeated submissions in order to gain sufficient momentum, which the reform will curtail. Among the reform's critics were the SEC's Office of the Investor Advocate and Investor Advisory Committee (IAC); the Consumer Federation of America; the Council of Institutional Investors, a large investor trade group; and the Interfaith Center on Corporate Responsibility, a faith-based investor coalition.

Opponents have undertaken several initiatives to vacate or undo the changes to Rule 14a-8. S.J.Res. 16 (Senator Sherrod Brown) and H.J.Res. 36 (Representative Michael F. Q. San Nicolas) are joint resolutions under the Congressional Review Act (CRA; P.L. 104-121) that provide for congressional disapproval of the SEC adopted shareholder proposals. If the resolutions had been passed by both chambers and signed by the President, the rule changes would have been vacated, and the SEC would have been prohibited from issuing a rule that was "substantially the same." However, the timeline for Congress to use the CRA's expedited procedures has expired.

On June 15, 2021, a group of investors led by the Interfaith Center on Corporate Responsibility filed a lawsuit against the SEC in the U.S. District Court in Washington, DC, asking the court to vacate the shareholder reforms. In addition, under President Biden the composition of SEC commissioners has changed, and when the SEC released the *Spring 2021 Unified Agenda of Regulatory and Deregulatory Action*, the agenda included newly appointed SEC Chair Gary Gensler's "Reg Flex Agenda." The agenda reflected the chairman's interest in revisiting and possibly attempting to reverse certain rulemakings finalized in the past two years under then-Chair Jay Clayton. The September 2020 Rule 14a-8 reform is part of that agenda.

Key Arguments in Support of the Reform

- When adopted in 1954—an era of snail mail and limited options for shareholder communications with firms and other shareholders—the 3%, 6%, and 10% thresholds may have been reasonable. Today, with expanded communication options (including video conferences, one-on-one meetings, shareholder surveys, and e-forums), many argue that seems to be much less the case.
- Under the 3%, 6%, and 10% thresholds, 90% or more of voting shareholders could oppose a proposal year after year, but it could still be reconsidered.
- A U.S. Chamber of Commerce research unit, the Center for Capital Markets Competitiveness, examined 2,449 shareholder proposals between 2001 and 2018 on environmental, social, political, and human rights matters. It found that (1) 5% attracted a majority of votes, while 32% had failed to gain a majority of votes after three or four submissions ("zombie" proposals); and (2) if the SEC had adopted its proposed 1997 resubmission protocol (of 6%, 15%, and 30%), which was fairly similar to that it adopted in 2020, 27% of the zombie proposals would have been eligible for a fourth submission.

Key Arguments Against the Reform

- The historical decline in proposals excluded from voting is likely due to an increase in overall shareholder support and greater awareness by proponents of how their proposals could ultimately benefit from modifications or from being temporarily withdrawn, not because the resubmission thresholds were too low.
- According to Ceres, a sustainability advocate, between 2010 and 2020, shareholders merely resubmitted ESG proposals 35 times at 26 firms.
- Research in 2020 conducted by the Council of Institutional Investors found that for proposals submitted between 2011 and 2019, the new thresholds would have more than doubled the number of excluded governance proposals, including proposals for independent board chairs and disclosures on political spending.

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