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CLIENT ALERT

SEC Adopts Amendments to Rules Governing Proxy Voting Advice and Proposes Modifications to Rule 14a-8

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AUTHORS

David K. Boston | Jared N. Fertman | Russell L. Leaf | Danielle Scalzo
Steven A. Seidman | Robert B. Stebbins

Amendments to Rules Governing Proxy Voting Advice

On July 13, 2022, the Securities and Exchange Commission (the "SEC" or the "Commission") voted 3-2 to adopt amendments to the rules governing proxy voting advice that were enacted last year.[1] Below is a brief history of the prior rulemaking in this area and a summary of the amendments.

Prior Developments.

On August 21, 2019, the SEC issued an interpretation affirming its long-standing view that proxy voting advice provided by proxy advisory firms generally constitutes a "solicitation" under the federal proxy rules (the "2019 Guidance").[2]

1 *See* Proxy Voting Advice, Securities Exchange Act of 1934 (the "Exchange Act") Release No. 95266 (July 13, 2022).

2 *See* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Release No. 86721 (Aug. 21, 2019).

On November 5, 2019, the SEC issued proposed amendments to its rules governing proxy voting advice provided by proxy advisory firms.[3]

On July 22, 2020, the SEC voted 3-2 to adopt final rules regarding proxy voting advice provided by proxy advisory firms (the "2020 Final Rules").[4] The 2020 Final Rules, among other things:

- Amended Rule 14a-1(1) under the Exchange Act to codify the SEC's interpretation that proxy voting advice generally constitutes a "solicitation" subject to the federal proxy rules;
- Adopted Rule 14a-2(b)(9) under the Exchange Act to add two new conditions that each proxy advisory firm would generally need to satisfy to avoid certain other proxy requirements. The conditions included:
  - (i) a conflicts of interest disclosure requirement; and
  - (ii) a requirement to adopt and disclose written policies reasonably designed to ensure that (A) each applicable issuer has the proxy voting advice of such proxy advisory firm available to it at the same time or prior to the time such advice is disseminated to clients of the proxy advisory firm and (B) the proxy advisory firm provides its clients with a mechanism (such as a hyperlink) by which the clients can be expected to become aware of any written statements by the applicable issuer regarding the proxy voting advice before the shareholders' meeting (this clause (ii) collectively, the "Rule 14a-2 Conditions"); and
- Added a new Note (e) to Exchange Act Rule 14a-9, which prohibits false and misleading statements, to include specific examples of material misstatements or omissions related to proxy voting advice.

The amendments to Rules 14a-1(1) and 14a-9 became effective on November 2, 2020 and the Rule 14a-2 Conditions became effective on December 1, 2021.

On June 1, 2021, SEC Chair Gary Gensler directed staff from the Division of Corporation Finance to consider whether to recommend further regulatory action regarding proxy voting advice.[5] Also on June 1, 2021, staff from the Division of Corporation Finance issued a statement (the "CF Statement") providing that, pending further regulatory action by the

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[3] *See* Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 87457 (Nov. 5, 2019).

[4] *See* Exemptions From the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 89372 (July 22, 2020).

[5] *See* Statement on the Application of the Proxy Rules to Proxy Voting Advice, Chair Gary Gensler (June 1, 2021).

SEC, the staff would not recommend that the Commission take enforcement actions based on the 2020 Final Rules or the 2019 Guidance.[6]

On October 13, 2021, the National Association of Manufacturers and the Natural Gas Services Group, Inc. filed a lawsuit as to the CF Statement. The lawsuit argues that the Administrative Procedure Act (the "APA") requires the SEC to engage in notice-and-comment rulemaking whenever it amends a regulation, including when it desires to suspend the regulation's effectiveness.[7]

On November 17, 2021, the SEC voted 3-2 to propose amendments partially amending the 2020 Final Rules[8] and on July 13, 2022 the SEC voted 3-2 to adopt the proposed amendments substantially as proposed (the "2022 Final Amendments").[9]

Final Rule Amendments.

The 2022 Final Amendments remove the Rule 14a-2 Conditions and remove Note (e) to Rule 14a-9. The conflicts of interest disclosure requirement is still in effect and proxy voting advice remains a "solicitation" subject to the federal proxy rules.

In addition, the Commission rescinded the supplemental guidance that it issued to investment advisers in 2020 about their proxy voting obligations.

The justifications for the 2020 Final Amendments have not materially changed since the proposing release for the 2021 proposed amendments. As to the removal of the Rule 14a-2 Conditions, the SEC in the adopting release noted that many investors still have strong concerns about the Rule 14a-2 Conditions and that most of the major proxy advisory firms have current practices that are likely, at least to some extent, to advance some of the goals underlying the Rule 14a-2 Conditions.

Dissent.

Commissioner Hester Peirce issued a statement in dissent, noting that when the Commission proposed to amend the 2020 Final Rules in November 2021, nothing had changed since adoption on July 22, 2020 to justify repeal, so she voted no, and the feedback received during the comment period confirmed this view. She also noted that changing course so

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6 *See* Statement on Compliance with the Commission's 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14(a)-1(1), 14(a)-2(b), 14(a)-9, Division of Corporation Finance (June 1, 2021).

7 *See* National Association of Manufacturers et al. v. SEC, No. 7:21-cv-183 (W.D. Tex.).

8 *See* Proxy Voting Advice, Exchange Act Release No. 93595 (Nov. 17, 2021).

9 *See* Proxy Voting Advice, Exchange Act Release No. 95266 (July 13, 2022).

dramatically with so little justification does not bode well for the Commission, asking what credibility the SEC will have as an independent agency if its regulations swerve so drastically from one year to the next, seemingly based on political rather than market signals.[10]

Takeaways.

As noted above, (i) in June 2021 the staff from the Division of Corporation Finance issued the CF Statement providing that the staff would not recommend that the Commission take enforcement actions based on the 2020 Final Rules or the 2019 Guidance and (ii) in response the National Association of Manufacturers and the Natural Gas Services Group, Inc. filed suit against the Commission challenging the SEC's "efforts to bypass the required notice-and-comment process to keep this lawfully issued rule on ice indefinitely."[11] After adoption of the 2022 Final Amendments, this litigation was stayed by the court. In addition to this legal challenge, commentators have criticized the suspension by the SEC staff of enforcement of rules recently adopted by the Commission.

Court challenges to the 2022 Final Amendments have already commenced. On July 28, 2022, a complaint was filed by the Chamber of Commerce of the United States and others against the SEC in the U.S. District Court in the Middle District of Tennessee. The complaint alleges that (i) the Commission failed to provide serious evidence of new or changed circumstances to justify its actions, (ii) the SEC failed to provide enhanced justifications for its policy reversals as required by the APA, and (iii) the cost-benefit analysis in the adopting release ignores the costs to companies and investors in violation of the APA.[12]

On July 21, 2022, the National Association of Manufacturers and Natural Gas Services Group, Inc. filed suit against the SEC in the U.S. District Court for the Western District of Texas, arguing that the 2022 Final Amendments are procedurally defective and arbitrary and capricious, and therefore must be set aside under the APA, as the Commission has come to an outcome completely opposite of that reached by the Commission only two years ago, and it has done so on the basis of the exact same factual record that drove the SEC to adopt the 2020 Final Rules.[13]

In these court proceedings, the Commission will be required to show that there are "good reasons" for the changes to the 2020 Final Rules.[14] This may not be easy for the Commission to do, given that the reasons set forth in the adopting

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10 *See* U-Turn; Comments on Proxy Voting Advice, Commissioner Hester Peirce (July 13, 2022).

11 Complaint, National Association of Manufacturers and Natural Gas Services Group, Inc. v. SEC and Gary Gensler, as Chairman, filed October 13, 2021.

12 Complaint, Chamber of Commerce of the United States of America, Business Roundtable and Tennessee Chamber of Commerce & Industry v. SEC and Gary Gensler, as Chairman, filed July 28, 2022.

13 Complaint, National Association of Manufacturers and Natural Gas Services Group, Inc. v. SEC and Gary Gensler, as Chairman, filed July 21, 2022.

14 Todd Garvey, A Brief Overview of Rulemaking and Judicial Review, Congressional Research Service (Mar. 27, 2017).

release for the removal of the Rule 14a-2 Conditions were already considered by the Commission when adopting the 2020 Final Rules and that the 2020 Final Rules never practically went into effect to allow a different factual record to develop.

In addition, one market-leading proxy advisory firm has filed a lawsuit in federal court against the SEC, challenging the 2020 Final Rules. The suit was being held in abeyance pending the 2020 Final Amendments; however, the proxy advisory firm recently stated that it is continuing the litigation to challenge the codification of the SEC's long-standing view that proxy voting advice generally constitutes a "solicitation" subject to the federal proxy rules.

Proposed Modifications to Rule 14a-8

Also on July 13, 2022, the Commission voted 3-2 to issue proposed rules (the "Proposed 14a-8 Amendments") updating certain bases for exclusion of shareholder proposals under Exchange Act Rule 14a-8.[15]

Rule 14a-8 requires companies that are subject to the federal proxy rules to include shareholder proposals in their proxy statements to shareholders, subject to certain procedural and substantive requirements.[16] Under Rule 14a-8, a company must include a shareholder's proposal in the company's proxy materials unless the proposal fails to satisfy any of several specified substantive requirements or the proposal or shareholder-proponent does not satisfy certain eligibility or procedural requirements.[17]

If a company intends to exclude a shareholder proposal from its proxy materials, it is required under Rule 14a-8(j)(1) to "file its reasons" for doing so with the Commission.[18] These notifications are generally submitted in the form of no-action requests, with companies seeking the staff's concurrence that they may exclude a shareholder proposal under one or more of the procedural or substantive bases under Rule 14a-8.[19]

Since Rule 14a-8 was adopted in 1942, the Commission has amended the rule on several occasions, most recently in September 2020. The Commission is proposing modification to three of the rule's substantive bases for exclusion: Rule 14a-8(i)(10) (substantial implementation), Rule 14a-8(i)(11) (duplication) and Rule 14a-8(i)(12) (resubmissions); the bases

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15 *See* Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals Under Exchange Act Rule 14a-8, Exchange Act Release No. 93267 (July 13, 2022).

16 *Id.* at p. 4.

17 *Id.* at p. 4.

18 *Id.* at p. 5.

19 *Id.* at p. 5.

for exclusion in those rules collectively represent a significant percentage of the no-action requests the staff receives under Rule 14a-8.[20]

Substantial Implementation.

First, the Commission proposes to amend the substantial implementation exclusion, which allows companies to exclude a shareholder proposal that "the company has already substantially implemented," which standard has remained substantively unchanged since 1983. During the 2021 proxy season, the staff received 110 no-action requests asserting the substantial implementation threshold, and the staff concurred with 36 of the requests.[21] As proposed to be amended, a company could only exclude a proposal under this exclusion if the company has already implemented the "essential elements" of the proposal.[22] Determining whether a proposal could be excluded under the proposed amendments would require a determination of which elements of the proposal are the "essential elements" and an analysis of whether those elements have been addressed.[23]

Duplication.

Second, the Commission proposes to amend the duplication exclusion, which allows companies to exclude a shareholder proposal if it substantially duplicates another shareholder proposal previously submitted to the company by another shareholder that will be included in the company's proxy statement for the same meeting.[24] This exclusion was adopted in 1976 and has remained substantively unchanged since adoption.[25] During the 2021 proxy season, the staff received 12 no-action requests asserting the duplication exclusion, and concurred in three of the requests. As proposed to be amended, a company could only exclude a proposal under this exclusion if the other proposal addresses the same subject matter and seeks the same objectives by the same means.[26]

In the proposing release the Commission noted that it was aware of the possibility that the proposed amendment could result in the inclusion in a company's proxy materials of multiple shareholder proposals dealing with the same or similar issue, which could cause shareholder confusion and may lead to conflicting or inconsistent results and implementation challenges for companies if shareholders approve multiple similar, although not duplicative, proposals.[27] Thus, the

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20 *Id.* at p. 7.

21 *Id.* at pp. 10-11.

22 *Id.* at p. 8.

23 *Id.* at p. 14.

24 *Id.* at p. 17.

25 *Id.* at p. 17.

26 *Id.* at p. 19.

27 *Id.* at p. 20.

proposing release seeks comment on the possible implications for companies and shareholders of the amendments to the duplication exclusion.

Resubmission.

Third, the Commission proposes to amend the resubmission exclusion, which currently provides that a shareholder proposal may be excluded from a company's proxy statement if (i) the proposal addresses substantially the same subject matter as a proposal previously included in the company's proxy materials within the preceding five calendar years, (ii) the matter was voted on at least once in the last three years and (iii) the matter 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.[28] During the 2021 proxy season, the staff received two no-action requests asserting the resubmission exclusion, and the staff concurred in one of the requests.[29]

Since 1948, the Commission has not required a company to include a shareholder proposal in its proxy statement if "substantially the same proposal" previously had been submitted for a shareholder vote and did not receive a specified minimum percentage of votes upon its most recent submission.[30] For many years following adoption of the provision, the staff interpreted the phrase "substantially the same proposal" to mean one that is virtually identical (in form as well as substance) to a proposal previously included in the issuer's proxy statement.[31]

In response to commentators who had asserted that the provision failed to accomplish its stated purpose because a proponent was able to evade exclusion of its proposal by simply changing the language of the proposal in a manner that precluded one from saying that the proposal is virtually identical to a prior proposal, in 1983 the Commission revised the resubmission exclusion to permit the exclusion of proposals dealing with "substantially the same subject matter" as proposals submitted in prior years that received support below specified vote thresholds.[32] This "substantially the same subject matter" test has been in place since 1983, though the Commission has revisited the minimum vote thresholds necessary for resubmission under the provision from time to time and increased the resubmission thresholds in 2020.[33]

In the proposing release, the Commission states that it shares the concerns of some commentators during the 2020 amendment process who felt that the "substantially the same subject matter" standard in place since 1983 unduly

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28 *Id.* at p. 9.

29 *Id.* at p. 22.

30 *Id.* at p. 22.

31 *Id.* at p. 23.

32 *Id.* at pp. 23-24.

33 *Id.* at p. 25.

constrains shareholder suffrage.[34] Thus, the Commission is proposing to amend the standard of what constitutes a resubmission under Rule 14a-8(i)(12) from a proposal that "addresses substantially the same subject matter" as a prior proposal to a proposal that "substantially duplicates" a prior proposal, which is the same standard that applies under the current duplication exclusion. The proposed amendments also would provide that a proposal "substantially duplicates" another proposal if it "addresses the same subject matter and seeks the same objective by the same means."[35]

Ordinary Business.

In addition, the proposing release also reaffirms the standards the Commission articulated in 1998 for determining whether a proposal relates to ordinary business for purposes of Rule 14a-8(i)(7), and as further discussed in a recent Staff Legal Bulletin. In the 1998 adopting release, the Commission stated that the policy underlying the ordinary business exclusion rests on two central considerations; the first relates to the subject matter of the proposal and the second consideration relates to the degree to which the proposal seeks 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.[36]

In November 2021, the Division of Corporation Finance issued a Staff Legal Bulletin regarding the ordinary business exception, [37] as well as the economic relevance exception under Rule 14a-8(i)(5).[38] The Bulletin also rescinded three prior Staff Legal Bulletins on Rule 14a-8 exclusions, which were issued from 2017 to 2019, and reversed the staff precedent from these prior Staff Legal Bulletins on the ordinary business exclusion.[39] As to the subject matter of the proposal, a proposal that the staff previously viewed as excludable because it did not raise a significant policy issue for the company would no longer be subject to exclusion if it raised an issue with a broad societal impact. As to micromanagement, the Bulletin made clear that a proposal suggesting targets or timelines (such as those dealing with

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34 *Id.* at pp. 26-27.

35 *Id.* at p. 27.

36 *Id.* at p. 7. As to the subject matter of the proposal, in the 1998 adopting release the Commission noted that proposals relating to ordinary business matters but focusing on significant social policy issues would generally not be excludable "because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote."

37 Division of Corporation Finance, Shareholder Proposals: Staff Legal Bulletin No. 14L (CF), Nov. 3, 2021.

38 *Id*. at pp. 3-4. The economic relevance exception permits a company to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." In connection with the rescinding of the prior Staff Legal Bulletins, the staff is taking the position that proposals which raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5).

39 *Id.* at p.1.

greenhouse gas emissions) would not be excludable as "micromanagement" so long as the proposal afforded discretion to management as to how to achieve the goals.[40]

Comments on the Proposed 14a-8 Amendments must be received by the later of September 12, 2022 or 30 days after the proposing release is published in the Federal Register.

Dissent.

Commissioner Peirce issued a statement in dissent, noting that Rule 14a-8 was amended less than two years ago and companies have yet to experience a full proxy season with the changes in effect, and stating that a better approach would have been to allow sufficient time to see how the September 2020 amendments operate and whether further changes are appropriate.[41]

As to the proposed amendments to the specific bases for exclusion, (i) for the substantial implementation exclusion, she noted that what constitutes an "essential element" is not clear and that the staff will defer to the assessment of the shareholder as to what is essential; (ii) for the duplication exclusion, she noted that given it will no longer provide a basis for exclusion unless the proposals are seeking exactly the same thing, the likely result is multiple overlapping or conflicting proposals on the same topic on the same proxy; and (iii) for the resubmissions exclusion, she noted that this basis will not exclude any proposal unless it is nearly identical to a prior proposal, and that shareholders will use this new language to get around the resubmission limits just as their pre-1983 counterparts did with the "substantially the same proposal" standard in effect at that time.[42]

Takeaways.

If the Proposed 14a-8 Amendments are enacted, it will likely be difficult for a company to obtain SEC staff concurrence with exclusion of a shareholder proposal from the company's proxy statement pursuant to the "duplication," "resubmissions" or "ordinary business" bases for exclusion under Rule 14a-8. Thus, as the SEC notes in the proposing release and as Commissioner Peirce notes in her dissent, enactment of the Proposed 14a-8 Amendments will substantially increase the risk a company will be required to include substantially similar items or conflicting proposals in its proxy statement. In addition, the Proposed 14a-8 Amendments will practically repeal the September 2020 amendments to Rule 14a-8.

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40 *Id.* at p.3.

41 *See* Exclusion Preclusion: Statement on the Shareholder Proposals Proposal, Commissioner Hester M. Peirce (July 13, 2022).

42 *Id.*

If a company intends to exclude a shareholder proposal from its proxy materials, it is required under Rule 14a-8(j)(1) to file its reasons for doing so with the Commission; these notifications are generally submitted in the form of no-action requests with companies seeking the staff's concurrence that they may exclude a shareholder proposal under one of the bases under Rule 14a-8.[43] Given the importance of the shareholder proposal system, the current views of the SEC and the staff of the Division of Corporation Finance as to exclusions to Rule 14a-8 (including that a company can be required to pay for the inclusion of a shareholder proposal in its proxy statement even if it is immaterial to the company so long as it relates to a broad issue of social concern as determined by the staff), the role of the staff in determining which proposals will be in a proxy statement, and the recent Supreme Court cases dealing with administrative processes such as Lucia, [44] it would not be surprising to see constitutional challenges (based on compelled speech arguments) raised to the current shareholder proposal system.

Also, prior to issuance of the proposing release, certain commentators suggested that if a company has a strong legal basis for exclusion of a shareholder proposal but is concerned that the SEC staff will nevertheless require inclusion of the proposal in the company's proxy statement, the company should consider excluding the proposal, filing its reasons for exclusion with the Commission instead of requesting no-action relief, and thus forcing a shareholder to go to federal court to contest the exclusion before a federal judge. However, if the Proposed 14a-8 Amendments are enacted, this strategy would seem impracticable in connection with the duplication," "resubmissions" or "ordinary business" bases for exclusion as it will likely be difficult to have a strong legal basis under Rule 14a-8 for such exclusion.

[43] Proposing Release at p. 5.

[44] Lucia, *et al.* v. SEC, Supreme Court of the U.S., June 21, 2018.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David K. Boston
212 728 8265
dboston@willkie.com

Jared N. Fertman
212 728 8670
jfertman@willkie.com

Russell L. Leaf
212 728 8593
rleaf@willkie.com

Danielle Scalzo
212 728 8620
dscalzo@willkie.com

Steven A. Seidman
212 728 8763
sseidman@willkie.com

Robert B. Stebbins
212 728 8736
rstebbins@willkie.com