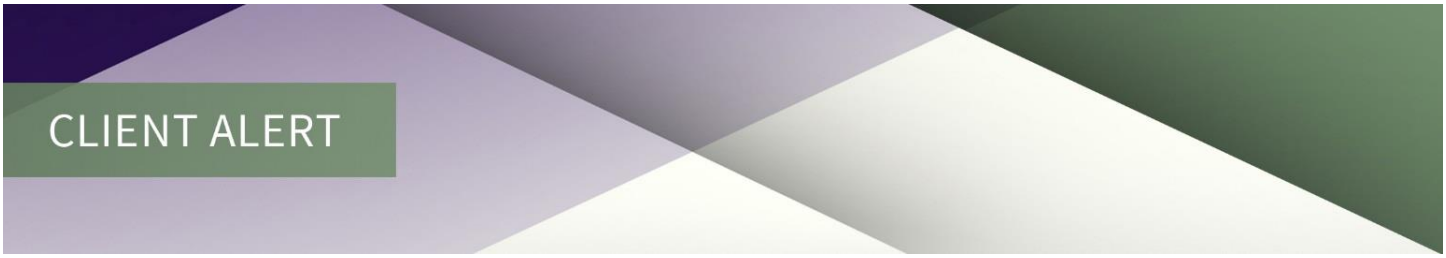

SEC Proposes Amendments to Proxy Rules

November 26, 2019

AUTHORS

James E. Anderson | Justin L. Browder | Richard F. Jackson

On November 5, 2019, the Securities and Exchange Commission ("SEC" or "Commission") voted 3-2 to propose two sets of amendments to the proxy rules under the Securities Exchange Act of 1934 ("Exchange Act"). One proposal would address issues relating to the status of proxy voting advisors under the proxy rules,[1] while the other would tighten the requirements that shareholders must meet to submit or resubmit proposals for inclusion in a company's proxy statement.[2] Comments on both proposals are due sixty days after publication in the Federal Register.

Proxy Voting Advisors

Following up on its recent issuance of an interpretive release and guidance regarding the application of the proxy rules to proxy voting advisory firms,[3] the SEC proposed to amend the definition of "solicitation" in Rule 14a-1 under the Exchange Act, certain exemptions available under Rule 14a-2, and the antifraud provision of Rule 14a-9. The SEC's stated intent was to "help ensure that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions, in a manner that does not impose undue costs or delays that could adversely affect the timely provision of proxy voting advice." If the amendments are adopted as proposed, however, the effect might be to make it more difficult for proxy advisory firms to furnish independent voting advice to their clients sufficiently far in advance to enable their clients to effectively exercise their voting rights as shareholders.

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

2 *See* Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, Exchange Act Release No. 87458 (Nov. 5, 2019), *available* here.

3 *See* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Release No. 86721 (Aug. 21, 2019), 84 Fed. Reg. 47416 (Sept. 10, 2019), *available* here; and Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325 (Sept. 10, 2019), 82 Fed. Reg. 47420 (Sept. 10, 2019), *available* here.

Definition. The SEC proposed to amend the definition of "solicitation" in Rule 14a-1 to codify its recent interpretation that proxy voting advice is a solicitation, even when the proxy advisor is not seeking to act as a shareholder's proxy. The proposed amendment would define solicitation to include:

> Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.[4]

The SEC stated in the proposing release that it had previously taken the position that the definition of solicitation might result in proxy advisory firms being subject to the proxy rules because, in its words, "they provide recommendations that are reasonably calculated to result in the procurement, withholding, or revocation of a proxy" and "the furnishing of proxy voting advice [generally] constitutes a solicitation."

Exemptions. Rule 14a-2 provides various exemptions from the filing and information requirements of the proxy rules. Proxy advisory firms, in particular, may rely on the exemptions provided by Rule 14a-2(b)(1) and Rule 14a-2(b)(3). The SEC proposed amendments to Rules 14a-2(b)(1) and (3), and proposed new Rule 14a-2(b)(9), to add new conditions governing a proxy advisory firm's ability to rely on those exemptions.

The SEC stated that the proposed amendments, if adopted, will improve the transparency of proxy advisory firms' methodologies, the disclosure of information about proxy advisors' conflicts of interest, and the accuracy of the information on which proxy advisors base their recommendations, and improve dialogue among issuers, proxy advisors and shareholders.

Disclosure of Conflicts. The SEC proposed that, as a condition to relying on the exemptions from the filing and information requirements of the proxy rules, a proxy voting advisor would have to include in any proxy voting advice, and in any electronic medium used to deliver the advice, specified disclosures about its conflicts of interest, including information about the following:

a. Any material interest it or its affiliates have in the matter or the parties about which it is providing advice;
b. Any material transaction or relationship it or its affiliates have with the issuer or its affiliates, another soliciting person or its affiliates, or a shareholder proponent or its affiliates in connection with the matter on which it is advising;

[4] Proposed Rule 14a-1(l)(iii)(A).

c. Any other information regarding such interest, transaction or relationship that is material to assessing the proxy advisor's objectivity; and
d. Any policies and procedures the proxy advisor uses to identify such conflicts and steps it has taken to address them.

Issuer Engagement. The SEC also proposed to require a proxy advisor to provide the issuer, and any other person conducting a solicitation that is not exempt under Rule 14a-2, with a copy of its advice before it delivers the advice to its clients and allow the issuer to review and provide comments on it, subject to certain conditions. An issuer would have to be given at least five business days to review and comment, if it filed its definitive proxy statement at least 45 days before the date of the shareholder meeting, or three business days if it was filed 25 - 44 days before the meeting. An issuer that filed its proxy statement less than 25 days before the meeting could not take advantage of this requirement.

As a technical matter, the proposed amendments do not require a proxy advisor to change its advice or analysis in response to issuer comments. However, the risk of expensive litigation and potential liability under Rule 14a-9 will put pressure on proxy advisors' ability to make these judgments independently.

Having received any comments from the issuer, a proxy advisor would be required to provide a final notice with a copy of its final report to the issuer or other solicitor at least two business days before disseminating its advice to its clients. A proxy advisor may require the issuer or other solicitor to execute a confidentiality agreement barring it from commenting on the advice before clients receive it. During this "final review period," a proxy advisor must, upon request, include in its advice and in any electronic medium used to deliver that advice, a hyperlink to a statement by the issuer or solicitor.

The SEC noted in the proposing release the risk of potentially significant adverse results for proxy advisory firms in the event of a failure to comply with the issuer engagement conditions, due to the fact that an advisor would lose its ability to rely on the exemptions. Accordingly, the proposed amendments provide that an immaterial or unintentional failure by a proxy advisor to comply with these conditions would not cause it to lose its exemption, provided that it acted in good faith, made a reasonable effort to comply, and, when feasible, used reasonable efforts to substantially comply as soon as practicable after becoming aware of its noncompliance.

Antifraud Rule. Rule 14a-9 under the Exchange Act prohibits false or misleading statements in proxy materials. The rule currently lists four examples of misleading statements. The SEC proposed to amend the rule to add a new provision making it misleading to fail to disclose material information regarding proxy voting advice, such as the proxy advisor's methodology, sources of information, conflicts of interest, or use of standards that materially differ from what the Commission has set or approved.

Shareholder Proposals

The SEC proposed amendments to Rule 14a-8, which governs the submission of shareholder proposals for inclusion in an issuer's proxy statement. The SEC stated that these amendments are generally intended to update and modernize the criteria used to govern the shareholder proposal process and to reduce the administrative burden on companies. The SEC's proposed amendments would increase the investment threshold required for the submission of proposals, make it easier for companies to exclude resubmitted proposals by increasing the vote required, and reinforce the one-proposal limit by extending it to shareholder representatives.

Eligibility. As proposed, a shareholder would be required to have continuously owned at least $2,000 in market value of an issuer's voting securities for at least three years, $15,000 in market value for at least two years, or $25,000 in market value for at least one year in order to submit a proposal for inclusion in an issuer's proxy statement. Currently, the rule requires a shareholder to have held $2,000 in market value of an issuer's voting securities, or 1% of the issuer's voting securities, for one year. The proposed amendments would do away with the 1% threshold. The proposed amendments also would bar different shareholders from aggregating their holdings to meet the minimum ownership thresholds, contrary to past practice.

To encourage shareholders to engage with companies directly, the SEC also proposed to require a shareholder to submit to the issuer a written statement indicating willingness to meet with the company in person or by phone to discuss the proposal. The shareholder would be required to provide contact information and business days and times when he or she would be available to discuss the proposal.

Resubmission. The SEC proposed to increase the threshold that a proposal must meet to be eligible for resubmission. If adopted, a shareholder proposal that addresses substantially the same subject matter as a proposal that was included in the company's proxy materials during the previous five years, where the most recent vote was within the preceding three years, could be excluded from the proxy statement if the previous proposal received:

- Less than 5% of the vote, if voted on once in the past five years;
- Less than 15% of the vote, if voted on twice in the past five years; or
- Less than 25% of the vote, if voted on three times in the past five years.

The rule currently sets these thresholds at 3%, 6% and 10%, respectively, over the same time periods.

In addition, the SEC proposed to add a new threshold applicable to shareholder proposals that have been voted on three times in the past five years and received at least 25% of the vote in the most recent vote. This amendment would permit a company to exclude a resubmitted proposal if it received less than 50% of the vote in the most recent vote, and the percentage of the vote received by the proposal declined 10% or more relative to the previous vote.

Representatives. The SEC proposed new requirements regarding shareholder representatives. The proposed amendments would require that if a shareholder relies on a representative to submit the proposal or otherwise to act on the shareholder's behalf, the shareholder would have to submit additional documentation. The SEC stated that the required documentation is intended to demonstrate that the shareholder authorized the representative to submit the proposal and act on the shareholder's behalf, and that the shareholder supported the proposal. In addition, a proposed amendment to the existing provision limiting shareholders to submitting only one proposal per meeting would change the provision to read that each "person" may submit only one proposal. The SEC stated that the purpose of this amendment is to prevent representatives from submitting multiple proposals on behalf of different shareholders, or on behalf of themselves and a shareholder.

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

James E. Anderson
202 303 1114
janderson@willkie.com

Justin L. Browder
202 303 1264
jbrowder@willkie.com

Richard F. Jackson
202 303 1121
rfjackson@willkie.com