JONES DAY

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GOVERNANCE PERSPECTIVES

Shareholder Proposals: Renewed Calls for Reform

- Current Rule 14a-8 process is outdated and requires substantial modernization.
- More companies are litigating for the exclusion of shareholder proposals in lieu of using the SEC's no-action process.
- SEC Commissioner Gallagher joins several business associations that have called for changes to the Rule 14a-8 process.

The 2014 proxy season is winding down, and the outcome of most of the shareholder proposals submitted for consideration has been determined. To date, shareholders submitted more than 800 proposals, which may be a record number. Roughly half of the proposals submitted in 2014 address environmental or social issues such as political activities and climate change, which typically garner low levels of shareholder support but continue to be resubmitted year after year. Remarkably, almost 20 percent of 2014 proposals were submitted by John Chevedden and Kenneth Steiner, perennial retail activists who typically hold only a nominal amount of shares in the companies they target. Although many shareholder proposals have no rational relationship to the creation of shareholder value, the flood of proposals submitted by corporate gadflies and investment funds pursuing special interests shows no sign of abating.

Shareholder proposals cost U.S. companies tens of millions of dollars each year, including the costs involved in negotiating with proponents, seeking SEC no-action relief to exclude proposals from proxy statements, and in preparing opposition statements. Of course, companies also spend millions more to implement successful shareholder proposals or to seek to mitigate the very real consequences—including withhold vote recommendations from proxy advisory firms—for failing to do so. Moreover, the voting policies of proxy advisory firms typically define a "successful" proposal as one that wins a majority of votes cast, which in many cases is far less than a majority of the outstanding shares.

Recently, several companies have taken their disputes over shareholder proposals to the courtroom rather than pursuing SEC no-action relief—signaling their frustration with the SEC's no-action process and abuses of the shareholder proposal system. Several companies have challenged Mr. Chevedden's approach of being designated as the "proxy" for another shareholder—in essence, renting shareholder status to pursue social interests that, while possibly laudable, do not really serve corporate interests. A number of companies have challenged Mr. Chevedden's proposals for including false and misleading statements. Although

many claims were dismissed on the grounds that the company failed to demonstrate imminent injury, at least two resulted in favorable rulings. One company won declaratory relief (which was upheld on appeal) against Mr. Chevedden's "proposal-by-renter-rather-than-owner" approach. Another company won declaratory relief after the SEC previously denied no-action relief for the exclusion of a proposal that included inaccurate statements about the company's executive compensation, corporate governance policies, and director election results. Although outcomes in shareholder proposal litigation may not be more predictable than those achieved through the SEC no-action process, at least some companies may continue to view litigation as a viable alternative for addressing perceived abuses of the shareholder proposal process.

In our view, the SEC's Rule 14a-8 shareholder proposal system is antiquated. We are not alone in the view that serious reform is required. This spring, SEC Commissioner Daniel Gallagher publicly criticized the Rule 14a-8 process, including the "absurdly low" holding requirement of $2,000 worth of shares, the loose requirements for proposal topics, and the lack of guidance available to the SEC staff for determining when to grant no-action relief—and the resulting inconsistency in staff positions. Commissioner Gallagher also challenged the low thresholds for resubmission of shareholder proposals—at most, proposals require only 10 percent support to permit resubmission in the following year.

The U.S. Chamber of Commerce, the National Association of Corporate Directors, and several other business groups have also questioned the low resubmission thresholds for shareholder proposals in a recent petition for SEC rulemaking. Those groups assert that the current rules fail to preclude repeated shareholder proposals that have no realistic likelihood of winning the support of a substantial percentage of shares, resulting in a "tyranny of the minority" in which a small number of shareholders can continuously override the will of the holders of 90 percent of shares, by forcing attention—and expenditure—on Quixotic missions.

Of course, the SEC has a substantial backlog of Dodd-Frank rulemaking initiatives, and a full-scale reform of the rules relating to shareholder proposals may not be forthcoming any time soon. We hope, however, that continuing calls for reform may spur real change in this area, beginning with a simple amendment to increase the proposal resubmission thresholds to a more appropriate level.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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