US Public Companies - Shareholder Proposals: Background and Process

This note was prepared on 8 February 2021. Your attention is drawn to the disclaimer at the end of this note.

Background

There is a growing consensus among shareholders that US companies take seriously and account for the issues of climate change and emissions in their business plans and corporate governance policies. While it true that shareholders have been submitting climate-change related proposals at US companies for years, only recently have companies and the institutional investors who hold much of their stock begun to take the threat of climate change seriously. And while this is certainly a welcome development, shareholder engagement on this issue will be critical in determining both the pace and focus of corporate America's transition to a more environmentally conscious modus operandi moving forward.

The institutional marketplace's recognition of the corporate need to combat climate change received a big boost in 2020 with BlackRock and State Street both signing on to the Climate Action 100+ investor initiative, a group of more than 540 investors, with over $52 trillion in assets under management, whose goal is to achieve enhanced corporate disclosure in line with the Task Force on Climate-related Financial Disclosures (the "**TCFD**") and to ensure improved climate governance and emissions reductions in line with The Paris Agreement. Notably, Vanguard has thus far declined to join the consortium.

More recently, in January 2021, BlackRock's CEO, Larry Fink, called on company CEOs to pursue sustainable value for all stakeholders and disclose plans for business models consistent with net zero greenhouse gas emissions by 2050. The burgeoning support for climate-related change is further evidenced by the fact that BlackRock voted for 24% of climate-related shareholder resolutions in 2020, a marked increase from just 5% the previous year, while State Street supported 50% of all climate-related shareholder resolutions during the same period.

Proxy advisors as well have come out in support of the ESG movement with ISS declaring ESG "a necessary part of institutional investing and asset management" and Glass Lewis launching a "Climate Policy" proxy voting policy (aligned with TCFD recommendations) for asset managers looking to incorporate climate risk factors into their proxy voting practices. On the exchange level, the NYSE hosts an online "central repository" of ESG resources on its website reflecting its "ongoing commitment to educate and inform our issuers about evolving environmental, social and governance matters" and NASDAQ engages with companies on ESG issues through its Corporate Sustainability initiative.

While gains in the corporate arena are being made, public company disclosure of the type the TCFD recommends is not currently mandatory in the US. That being said, shareholders can expect the SEC under the Biden administration to take a pro-disclosure stance in the near term as candidate President Biden campaigned on requiring companies to provide more disclosure on environmental risks and emissions and President Biden's pick for next Chair of the SEC, Gary Gensler, is widely thought to be in favor of instituting new climate-related disclosure rules. Further, a congressional bill introduced in 2019 by Senator Elizabeth Warren, the Climate Risk Disclosure Act of 2019, aims to direct the SEC to draft new rules requiring issuers to disclose, among other things, their greenhouse gas emissions. The bill currently sits before the Committee on Banking, Housing, and Urban Affairs, whose new chair, Senator Sherrod Brown, has stated he would seek to fight climate related issues through his role on the Committee. While the prospect of mandatory disclosure is as real as it's ever been, the timing and extent of such future regulation is yet unclear and may take years to be fully implemented which is why prudent shareholders must be proactive and continue to demand preemptive action from their companies' boards to accelerate a process that has taken far too long to gain hold.

U.S. proxy regulations provide a relatively simple avenue through which shareholders with relatively small holdings of large public companies can submit proposals, including proposals relating to disclosure of a company's greenhouse gas emission levels and any reduction plans relating thereto, to be voted on by other shareholders at annual meetings of shareholders of public companies. Though these proposals are usually (though not necessarily) advisory or "precatory" they can still have a big impact on a company's business and operations via the public pressure they bring to bear.

Rule 14a-8 Proposals in General

In general, shareholders submit proposals pursuant to Rule 14a-8 under Section 14(a) of the Securities Exchange Act of 1934. A shareholder is entitled to submit only one 14a-8 proposal per company per year and each proposal cannot be longer than 500 words, which includes any supporting statement the shareholder may attach to the proposal. The shareholder, or an authorized representative of the shareholder, must attend the annual meeting to present the proposal.

Eligible Shareholders

Under the rules currently in effect, to be eligible to submit a 14a-8 proposal, a shareholder must have owned, continuously for at least one year prior to submitting the proposal, $2,000 of the company's stock or 1% of the company's securities entitled to vote on the proposal. The shareholder must also continue to hold at least $2,000 or the 1% through the date of the annual meeting and must represent that it will do so when it submits its 14a-8 proposal to the company.

Note, however, that per a recent Rule 14a-8 amendment, for annual meetings that are to be held on or after January 1, 2022, the ownership threshold will increase from $2,000 held for one year to either (i) $25,000 held for one year, (ii) $15,000 held for two years or (iii) $2,000 held for three years. There is an exception for shareholders who will have held at least $2,000 in stock for at least one year prior to whenever the amendment is officially published in the federal register (which has yet to occur) and continues to hold $2,000 in stock through the date the proposal is submitted to the company.

Proof of Eligibility

When submitting a 14a-8 proposal, a shareholder must provide the company with proof of eligibility. This is typically done by providing the company with a written statement from the "record holder" of the shareholder's securities (usually a broker or bank) verifying that at the time of submission the shareholder had continuously held the securities ($2,000 or 1%) for at least one year prior and through the date of submission (the broker letter should be dated the day of submission). Large shareholders who own 5% or more a company's voting securities and have filed a Schedule 13D or Schedule 13G with the Securities and Exchange Commission (the "**SEC**") can provide copies of these filings and any filing amendments as evidence of the shareholder's eligibility.

For those shareholders relying on a bank or broker letter, below is an example letter:

[BROKER LETTERHEAD]

[DATE] [NOTE: MUST BE SAME DATE YOU SUBMIT PROPOSAL]

[COMPANY NAME]

[COMPANY ADDRESS]

ATTN: [COMPANY SECRETARY]

To Whom it May Concern,

Please be advised that [BROKER NAME] holds and has continuously held a minimum of $2,000 in market value of [COMPANY], [CUSIP NUMBER], on behalf of [FUND/ENTITY/PERSON], since [DATE] through the date hereof.

As a custodian for [FUND/ENTITY/PERSON], [BROKER NAME] holds these shares with the Depository Trust and Clearing Corporation under participant number [NUMBER].

If there are any questions concerning this matter, please do not hesitate to contact me directly.

____

[BROKER/BROKERAGE SIGNATURE]

Schedule 13G Filers

Submitting a 14a-8 proposal alone is generally deemed to be consistent with the passive intent generally required of a Schedule 13G filer. However, the determination of whether one submitting a 14a-8 proposal is eligible to file on Schedule 13G is based on a facts and circumstances analysis that should be made with your counsel.

Hart Scott Rodino Act Compliance

The Hart Scott Rodino Act ("**HSR Act**") generally requires an investor to make a pre-acquisition filing for holdings of an issuer in exceeding $94 million, unless an exemption applies. If a filing under the HSR Act is required, a party must file a notification, give notice to the issuer, and observe a 30-day waiting period prior to crossing the $94 million threshold. If parties fail to make a required HSR notification or observe the waiting period, the U.S. Federal Trade Commission ("**FTC**") may impose a civil penalty not to exceed $43,280 per day.[1]

Many investors rely on the 16 C.F.R. §802.9 exemption to the HSR Act reporting requirements that exempts holdings of 10% or less if the investor acquires the issuer's voting securities "solely for purposes of investment."

Some investors who rely on this investment intent exemption may have questions as to whether participation in Say on Climate may affect how the FTC would view their intent with respect to this exemption. Firstly, we note that the HSR regulations generally allow a shareholder to vote its shares for or against management, including on a Rule 14a-8 proposal, without running afoul of the investment only exemption. Second, the FTC's Premerger Notification Office ("**PNO**") has recently advised that making a Rule 14a-8 shareholder proposal does not preclude an investment-only intent when applied to a shareholder that requests that an issuer disclose information about its climate plans to its shareholders. The PNO further advises that it takes all the facts into consideration and a shareholder relying on the investment only exemption would need to make the final call and be prepared to defend any decision not to file under the HSR Act and observe the waiting period if the FTC investigates. However, investors should consult with your counsel on all matters relating to the HSR Act and any advice or guidance issued by the PNO.

If a shareholder wishes to go beyond voting for or making a Rule 14a-8 proposal, such as by direct engagement with company management on issues related to Say on Climate, it should consult in advance with competent HSR counsel in order to determine whether any proposed engagement might impact its ability to continue to rely on the investment only HSR exemption. Depending on the proposed activity and potential HSR consequences, a shareholder may want to craft its engagement efforts to remain consistent with the investment only HSR exemption, or may deem it prudent to make a HSR Act notification in order to eliminate any HSR compliance risk.

[1] These are 2020 figures; new filing thresholds and penalties will be announced in January and effective in February 2021. Note that the HSR Act thresholds are based on US GDP, so given the effects of COVID on 2020 US GDP, these thresholds are likely to be lowered in 2021.

Submission Timeline

14a-8 Proposals must be submitted at least 120 calendar days before the anniversary date of the company's previous year's proxy statement.[2]

14a-8 Proposal Exclusions & No-Action Request Letters

Companies may rely on various grounds under Rule 14a-8 to exclude a proposal from being presented at an annual meeting, and, in doing so, may request a letter of "No Action" from the SEC if the company intends to exclude the proposal from its proxy statement for an annual meeting. If a company chooses to submit a No-Action request letter to the SEC, it must do so at least 80 calendar days before it files its definitive proxy statement for the meeting in question. Shareholders can respond to the company by sending the SEC a letter of its own rebutting the company's arguments for exclusion.

Bases for Exclusion

There are two categories of exclusion—procedural and substantive—that companies may use to try and exclude a 14a-8 Proposal:

Procedural: Claims of procedural deficiency usually relate to problems with the shareholder's eligibility to submit, such as problems with shareholder's broker letter or its ownership of company voting securities. In these circumstances, the company is required to notify the shareholder of the purported procedural deficiency and provide the shareholder with 14 days to cure the deficiency.

Substantive: Rule 14s-8 enumerates thirteen different substantive bases for exclusion:

1. The proposal's subject matter would be in conflict with the laws of the state or jurisdiction in which the company is incorporated.

2. The proposal, if implemented, would cause the company to violate any state, federal or foreign law to which it is subject.

3. The proposal or supporting statement runs afoul of any of the SEC's proxy rules, including Rule 14a-9, which prohibits any false or misleading statements in the course of a proxy solicitation.

4. The proposal is personal in nature (i.e. relating to a personal grievance between the shareholder and the company) and not designed to benefit the company's other shareholders.

---

[2] If the company did not hold an annual meeting during the previous year, or if the date of the annual meeting has been changed by more than 30 days from the date of the previous year's annual meeting, the shareholder must submit the 14a-8 proposal a reasonable time before the company begins to print and mail its proxy materials.

5. The proposals relates to operations of the company that account for less than 5% of the company's total assets (and less than 5% of its net earnings and gross sales) and is not significantly otherwise related to the company's business.[3]

6. The proposals requests the company to do something that the company has no power or authority to do.

7. The proposal relates to the company's "ordinary business" operation, such that it infringes on management's ability to run the day to day operations of the business or the proposal "micromanages" the company "by probing too deeply into matters of a complex nature [. . . .]"

8. The proposals seeks to nominate or remove the company's directors.

9. The proposal is in direct conflict with a proposal that management will be presenting at the same meeting.

10. The proposal asks the company to implement something that it has already "substantially implemented."

11. The proposal is duplicative of another shareholder proposal to be included at the same meeting.

12. The proposal deals with substantially the same subject matter as another proposal or proposals that had been submitted once, twice or three or more times in the preceding five calendar years and received less than 3%, 6% and 10% of shareholder votes, respectively.[4]

13. The proposal asks the company to distribute specific amounts of cash or dividends.

Conclusion

Rule 14a-8 provides a means by which shareholders of public companies can voice their opinions at annual shareholder meetings without the expense of circulating and filing proxy materials. Though Rule 14a-8 itself is fairly simple on its face, there is a deep and rich policy and legal history behind the rule and shareholders should coordinate any submissions with competent counsel before making a submission.

---

[3] Note that proposals addressing significant policy issues will often be permitted even if they do not meet the foregoing economic metrics.

[4] Note, however, that per a recent amendment to Rule 14a-8 these thresholds will increase to 5%, 15% and 25%, respectively, for proposals that are submitted for meetings that are to be held on or after January 1, 2022.

Counsel

This note was prepared by attorneys at Schulte Roth & Zabel LLP and Schulte Roth & Zabel International LLP. Investors considering taking any of the of the actions described in this note should seek independent legal advice in advance from their own counsel.

Disclaimer