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February 24, 2015

Shareholder Proposals And Procedural Requirements

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

Although in the small cap marketplace, proxy season really spreads all year, the majority of issuers hold annual meetings in connection with the issuance of their annual reports and the majority of issuers have a December 31 fiscal year end. Accordingly, in the coming months, public companies will be preparing their annual shareholder meeting notices and be dealing with the associated shareholder proposals.

The regulation of corporate law rests primarily within the power and authority of the states. However, for public companies, the federal government imposes various corporate law mandates including those related to matters of corporate governance. While state law may dictate that shareholders have the right to elect directors, the minimum and maximum time allowed for notice of shareholder meetings, and what matters may be properly considered by shareholders at annual meeting, Section 14 of the Securities Exchange Act of 1934 ("Exchange Act") and the rules promulgated thereunder, govern the proxy process itself for publicly reporting companies.

All companies with securities registered under the Exchange Act are subject to the Exchange Act proxy regulations found in Section 14 and its underlying rules. Section 14 of the Exchange Act and its rules govern the timing and content of information provided to shareholders in connection with annual and special meetings with a goal of providing shareholders meaningful information to make informed decisions, and a valuable method to allow them to participate in the shareholder voting process without the necessity of being physically present. As with all disclosure documents, and especially those with the purpose of evoking a particular active response, such as buying stock or returning proxy cards, the SEC has established robust rules governing the procedure for, and form and content of, the disclosures.

The underlying premise of an annual or special meeting is that the company is soliciting the shareholders to vote in favor of particular matters, such as particular directors or particular corporate actions. Accordingly, the proxy is prepared by the company, presenting matters the company's board of directors have already approved or recommended for approval and has an underlying goal of getting the shareholder to return a proxy card with a "yes" vote. However, Rule 14a-8 allows shareholders to submit proposals and, subject to certain exclusions, require a company to include such proposals in the proxy solicitation materials, and is accordingly a source of much contention.

Rule 14a-8 in particular allows a qualifying shareholder to submit proposals that meet substantive and procedural requirements to be included in the company's proxy materials for annual and special meetings, and provide a method for companies to either accept or attempt to exclude such proposals. State laws in general allow a shareholder to attend a meeting in person and, at such meeting, to make a proposal to be voted upon by the shareholders at large. In adopting Rule 14a-8, the SEC provides a process and parameters for which these proposals can be made in advance and included in the proxy process.

As shareholder activism in general has increased, Rule 14a-8 has been the subject of much debate and controversy, which controversy has expanded exponentially since the SEC adopted amendments to the Rule to require a company to include in its proxy materials any proposals from qualifying shareholders that would amend, or request an amendment to, a company's director nomination procedures in its charter documents, as long as such amendment would not conflict with or violate applicable law.

Over the years the SEC has issued guidance on the rule, including Staff Legal Bulletin No. 14 published on July 13, 2001. An entire treatise could be written on Rule 14a-8, including SEC guidance and court interpretation. On February 10, 2015, Keith F. Higgens, Director of the SEC Division of Corporation Finance, gave an interesting speech on Rule 14a-8 governing shareholder proposals in the proxy process. The entire speech is available on the SEC website. The blog gives a high-level outline of the rule and a brief summary of Mr. Higgens' recent speech.

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Shareholder Proposals – Rule 14a-8

Rule 14a-8 of Regulation 14A permits qualifying shareholders to submit matters for inclusion in the company's proxy statement for consideration by the shareholders at the company's annual meeting. The rule itself is written in "plain English" in a question-and-answer format designed to be easily understood and interpreted by shareholders relying on and using the rule.

Shareholder Qualification and Procedure

Procedurally, to qualify to submit a proposal, a shareholder must:

Continuously hold a minimum of $2,000 in market value or 1% of the company's securities entitled to vote on the subject proposal, for at least one year prior to the date the proposal is submitted and through the date of the annual meeting;

If the securities are not held of record by the shareholder, such as if they are in street name in a brokerage account, the shareholder must prove its ownership by either providing a written statement from the record owner (i.e., brokerage firm or bank) or by submitting a copy of filed Schedules 13D or 13G or Forms 3, 4 or 5 establishing such ownership for the required period of time;

If the shareholder does not hold the requisite number of securities through the date of the meeting, the company can exclude any proposal made by that shareholder for the following two years;

Provide a written statement to the company that the submitting shareholder intends to continue to hold the securities through the date of the meeting;

Clearly state the proposal and course of action that the shareholder desires the company to follow;

Submit no more than one proposal for a particular annual meeting;

Submit the proposal prior to the deadline, which is 120 calendar days before the anniversary of the date on which the company's proxy materials for the prior year's annual meeting were delivered to shareholders, or if no prior annual meeting or if the proposal relates to a special meeting, then within a reasonable time before the company begins to print and send its proxy materials;

Attend the annual meeting or arrange for a qualified representative to attend the meeting on their behalf; provided, however, that attendance may be in the same fashion as allowed for other shareholders such as in person or by electronic media;

If the shareholder or their qualified representative fails to attend the meeting without good cause, the company can exclude any proposal made by that shareholder for the following two years;

The proposal, including any accompanying supporting statement, cannot exceed 500 words. If the proposal is included in the company's proxy materials, the statement submitted in support thereof will also be included.

A proposal that does not meet the procedural requirements may be excluded by the company. To exclude the proposal on procedural grounds, the company must notify the shareholder of the deficiency within 14 days of receipt of the proposal and allow the shareholder to cure the problem. The shareholder has 14 days from receipt of the deficiency notice to cure and resubmit the proposal. If the deficiency could not be cured, such as because it was submitted after the 120-day deadline, no notice or opportunity to cure must be provided.

Company Response to Shareholder Proposal

Upon receipt of a shareholder proposal, a company has many options. The company can elect to include the proposal in the proxy materials. In such case, the company may make a recommendation to vote for or against the proposal, or not take a position at all and simply include the proposal as submitted by the shareholder. If the company intends to recommend a vote against the proposal (i.e., Statement of Opposition), it must follow specified rules as to the form and content of the recommendation. A copy of the Statement of Opposition must be provided to the shareholder no later than 30 days prior to filing a definitive proxy statement with the SEC.

If included in the proxy materials, the company must place the proposal on the proxy card with check-the-box choices for approval, disapproval or abstention.

The company may seek to exclude the proposal based on procedural deficiencies, in which case it will need to notify the shareholder and provide a right to cure as discussed above. The company may also seek to exclude the proposal based on substantive grounds, in which case it will need to file a no-action letter with the SEC seeking

confirmation of its decision and provide a copy of the letter to the shareholder as further discussed below.

Finally, the company may meet with the shareholder and provide a mutually agreed upon resolution to the requested proposal. According to the 2014 Annual Corporate Governance Review released by Georgeson, Inc., approximately 43 percent of the proposals submitted by shareholders in 2014 were later withdrawn or omitted from the proxy statement and not considered at the annual meeting as a result of these negotiations.

Substantive Requirements and Grounds for Exclusion

If a company seeks to exclude a proposal based on most of the substantive grounds, it must seek concurrence from the SEC by utilizing the SEC no-action letter process. That is, the company must submit a no-action letter to the SEC explaining the reasons for excluding the proposal and seeking confirmation that the SEC will not consider the exclusion a violation of Rule 14a-8. The letter must be submitted no later than 80 days prior to filing a definitive proxy statement with the SEC. The shareholder must be provided a copy of the no-action letter submittal and has the opportunity to reply to the company and the SEC. The SEC may require agreement with the company's request to exclude the proposal, require unconditional inclusion of the proposal, or provide for shareholder revision of the proposal as a condition to requiring its inclusion.

The company faces the burden of proving that a particular shareholder proposal may be excluded from the proxy materials. In the no-action process, the SEC will only consider the facts, arguments and information submitted by the company, so it is very important that a company work with company counsel to ensure a comprehensive submittal. Like the registration process, the SEC bases its determination on the disclosure and ultimate information that will be provided to shareholders in proxy statements, as opposed to the underlying merits of the requested shareholder proposal. Moreover, the decision by the SEC is as to whether they would pursue enforcement against the company for a violation of Rule 14a-8 for an exclusion of the proposal, but is not otherwise binding on the company or shareholder.

On January 16, 2015, the SEC announced that it would no longer respond to no-action letters seeking exclusion of shareholder proposals on the grounds that the proposal

directly conflicts with one of the company's own proposals to be submitted to shareholders and the same meeting.

Rule 14a-8 provides many substantive grounds in which a company may exclude a proposal from the proxy, including if:

The proposal is not a proper subject for shareholder vote in accordance with state corporate law;

The proposal would bind the company to take a certain action as opposed to recommending that the board of directors or company take a certain action;

The proposal would cause the company to violate any state, federal or foreign law, including other proxy rules;

The proposal would cause the company to publish materially false or misleading statements in its proxy materials;

The proposal relates to a personal claim or grievance against the company or others or is designed to benefit that particular shareholder to the exclusion of the rest of the shareholders;

The proposal relates to immaterial operations or actions by the company in that it relates to less than 5% of the company's total assets, earnings, sales or other quantitative metrics;

The proposal requests actions or changes in ordinary business operations, including the termination, hiring or promotion of employees, provided, however, that proposals may relate to succession planning for a CEO;

The proposal requests that the company take action that it is not legally capable of or does not have the legal authority to perform;

The proposal seeks to disqualify a director nominee or specifically include a director for nomination;

The proposal seeks to remove an existing director whose term is not completed;

The proposal questions the competence, business judgment or character of one or more director nominees;

The company has already substantially implemented the requested action;

The proposal is substantially similar to another shareholder proposal that will already be included in the proxy materials;

The proposal is substantially similar to a proposal that was included in the company proxy materials within the last five years and received fewer than a specified number of votes; or

The proposal seeks to require the payment of a dividend.

Keith F. Higgens, Director of the SEC Division of Corporation Finance, Speech

On February 10, 2015, Keith F. Higgens, Director of the SEC Division of Corporation Finance, gave a speech on Rule 14a-8 as part of a Practicing Law Institute program for continuing legal education. Mr. Higgens' speech is timely as there has been increasing controversy and court intervention in the shareholder proposal process and interpretation. Accordingly, the SEC is giving the entire Rule 14a-8 considerable focus and attention, and new interpretations and possible rule changes are likely.

Mr. Higgens began by discussing the relationship between federal regulation of the proxy process and state authority over corporate law. Mr. Higgens stressed that the federal proxy regulations merely give effect to existing state law rights to receive notice of meetings and for shareholders to submit proposals to be voted on by fellow shareholders. I found this of particular interest in light of recent potential conflicts between state and federal actions related to the processing of corporate actions by FINRA. See my blog HERE for more on that topic.

Mr. Higgens continues with a discussion of the no-action process related to company requests to exclude shareholder proposals. Hundreds of no-action letters are filed by companies each year seeking SEC agreement that specific proposals may be excluded. Mr. Higgens stresses that the process is non-binding and that the SEC is acting as "an informal arbitrator in the shareholder proposal process, assisting both companies and shareholder proponents, who might otherwise have to resort to litigation to resolve their disagreements." He continues that the "views are informal staff views, purely advisory and non-binding" and that only a court can issue a binding ruling. Accordingly, as the entire industry is aware, Mr. Higgens points out that in recent years many companies

and shareholders have determined to utilize the federal courts in addition to, or in lieu of, the SEC no-action process.

His speech points out that the courts have not necessarily been agreement with the SEC's long-standing analysis and underlying policy as of late.

One prominent recent ruling is the Trinity Wall Street v. Wal-Mart Stores, Inc. ruling by the U.S. District Court in Delaware. Mr. Higgens discusses this case in his speech. The shareholder proposal in the Trinity case, as described by Mr. Higgens, requested that the board assign a committee the responsibility of "overseeing the formulation, implementation, and public reporting of policies that determine whether the company should sell a product that especially endangers public safety and well-being, has the potential to impair the company's reputation, or would be considered offensive to the values integral to the company's brand." The SEC supported the company's exclusion of the proposal as being the subject of ordinary course of business matters; however, the court sided with the shareholder and concluded that the proposal was improperly excluded.

As Mr. Higgens explained, the court found "that because the proposal merely sought board oversight of the development and implementation of a company policy, leaving day to day aspects of implementation of this policy to the company's officers and employees, the proposal itself did not have the consequence of dictating what products Wal-Mart could sell." The SEC, in contrast, had considered whether the underlying issue involved ordinary business matters and determined in this case that it did. The company has appealed the court decision.

Mr. Higgens then discusses the controversial "conflicting proposals" basis for exclusion. As noted, on January 16, 2015, the SEC announced that it would no longer respond to no-action letters seeking exclusion of shareholder proposals on the grounds that the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting. Historically the SEC has allowed conflicting proposals to be excluded if the inclusion of both proposals could "present alternative and conflicting decisions for shareholders and that submitting both proposals to a vote could provide inconsistent and ambiguous results."

Beginning in 2009 there has been a substantial increase in proposals and company counterproposals that conflict. In particular, for example, as explained in the speech, a

shareholder could request that the company amend its bylaws to permit shareholders holding 10% of the outstanding stock to hold a special meeting and a company could counter with its own proposal setting a 25% or some other threshold. The company could then seek to exclude the shareholder proposal as conflicting with its own on the same subject.

Last year Whole Foods sought to exclude a shareholder proposal that would allow shareholders owning at least 3% of the outstanding stock for at least 3 years to nominate up to 20% of the directors but no fewer than 2. Whole Foods responded with its own proposal allowing any shareholder that owned at least 9% of the outstanding stock for at least 5 years to nominate 10% of the directors but no fewer than 1. The SEC supported Whole Foods and the shareholder sought reconsideration. The SEC then decided not to address any exclusion requests related on conflicting proposals, including that of Whole Foods. In other words, the SEC bowed out of the fight altogether

Mr. Higgens discusses in general the different possible inquiries in applying the historical analysis of exclusion based on conflicting proposals. Obviously the standards are difficult to apply. Mr. Higgens' speech in general is well thought out and provides insight into the differing potential views and underlying analysis for the application of Rule 14a-8.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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